INSURANCE ADJUSTMENTS

THE HOME INSURANCE COMPANY
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INDEX

CO-INSURANCE

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BY

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The Co-insurance Clause

Of the more important clauses in current use, the one most frequently used, most severely criticized, most misunderstood, most legislated against, and withal the most reasonable and most equitable, is that which in general terms is known as the "co-insurance clause."

Insurance is one of the great necessities of our business, social and economic life, and the expense of maintaining it should be distributed among the property owners of the country as equitably as it is humanly possible so to do.

Losses and expenses are paid out of premiums collected. When a loss is total the penalty for underinsurance falls where it properly belongs, on the insured who has elected to save premium and assume a portion of the risk himself, and the same penalty for underinsurance should by contract be made to apply in case of partial loss as applies automatically in case of total loss.

If all losses were total, liberality on the part of the insured in the payment of premium would bring its own reward, and parsimony would bring its own penalty; but the records of the leading companies show that of all the losses sustained, about 65%—numerically—are less than $100; about 30% are between $100 and total; and about 5% are total. The natural inclination, therefore, on the part of the public, particularly on the less hazardous risks, is to underinsure and take the chance of not having a total loss; and this will generally be done except under special conditions, or when reasonably full insurance must be carried to sustain credit or as collateral security for loans. There were several striking illustrations of this in the San Francisco conflagration, where the amount of insurance carried on so-called fireproof buildings was less than 10% of their value, and the insured in such instances, of course, paid a heavy penalty for their neglect to carry adequate insurance.

Co-insurance operates only in case of partial loss, where both the insurance carried and the loss sustained are less than the prescribed percentage named in the clause, and has the effect of preventing one who has insured for a small percentage of value and paid a correspondingly small premium from collecting as much in the event of loss as one who has insured for a large percentage of value and paid a correspondingly large premium. We have high authority for the principle,

> "He which soweth sparingly shall reap also sparingly, and he which soweth bountifully shall reap also bountifully."

and it should be applied to contracts of insurance. Rating systems may come, and rating systems may go; but, unless the principle of co-insurance be recognized and universally applied, there can be no equitable division of the insurance burden, and the existing inequalities will go on forever. The principle is so well established in some countries that the general foreign form of policy issued by the London offices for use therein contains the full co-insurance clause in the printed conditions.

The necessity for co-insurance as an equalizer of rates was quite forcibly illustrated by a prominent underwriter in an address delivered several years ago, in the following example involving two buildings of superior construction:

"A'S" BUILDING		"B'S" BUILDING	
Value	$100,000	Value	$100,000
Insurance	80,000	Insurance	10,000
Rate 1%		Rate 1%	
Premium received— one year,	800	Premium received— one year,	100
No Co-insurance Clause		No Co-insurance Clause	
Loss	800	Loss	800
Loss Collectible	800	Loss Collectible	800

"B" pays only one-eighth as much premium as "A," yet both collect the same amount of loss, and in the absence of co-insurance conditions both would collect the same amount in all instances where the loss is $10,000 or less. Of course, if the loss should exceed $10,000, "A" would reap his reward, and "B" would pay his penalty. This situation clearly calls either for a difference in rate in favor of "A" or for a difference in loss collection as against "B," and the latter can be regulated only through the medium of a co-insurance condition in the policy.

At this point it may not be amiss incidentally to inquire why the owner of a building which is heavily encumbered, whose policies are payable to a mortgagee (particularly a junior encumbrancer) under a mortgagee clause, and where subrogation may be of little or no value, should have the benefit of the same rate as the owner of another building of similar construction with similar occupancy, but unencumbered.

In some states rates are made with and without co-insurance conditions, quite a material reduction in the basis rate being allowed for the insertion of the 80% clause in the policy, and a further reduction for the use of the 90% and 100% clauses. This, however, does not go far enough, and any variation in rate should be graded according to the co-

insurance percentage named in the clause, and this gradation should not be restricted, as it is, to 80%, 90% or 100%, if the principle of equalization is to be maintained.

Various clauses designed to give practical effect to the co-insurance principle have been in use in this country for nearly forty years in connection with fire and other contracts of insurance. Some of these are well adapted to the purpose intended, while others fail to accomplish said purpose under certain conditions; but, fortunately, incidents of this nature are not of frequent occurrence.

There are, generally speaking, four forms, which differ quite materially in phraseology, and sometimes differ in practical application. These four clauses are: (1) the old co-insurance clause; (2) the percentage co-insurance clause; (3) the average clause; (4) the reduced rate contribution clause.

Until recently, underwriters were complacently using some of these titles indiscriminately in certain portions of the country, under the assumption that the clauses, although differently phrased, were in effect the same, but they were subjected to quite a rude awakening by a decision which was handed down about a year ago by the Tennessee Court of Civic Appeals. The law in Tennessee permits the use of the three-fourths value clause and the co-insurance clause, but permits no other restrictive provisions. The form in use bore the inscription "Co-insurance Clause," but the context was the phraseology of the reduced rate contribution clause, and although the result was the same under the operation of either, the court held that the form used was not the co-insurance clause, hence it was void and consequently inoperative. Thompson vs. Concordia Fire Ins. Co. (Tenn. 1919) 215 S.W. Rep. 932, 55 Ins. Law Journal 122.

The law of Georgia provides that all insurance companies shall pay the full amount of loss sustained up to the amount of insurance expressed in the policy, and that all stipulations in such policies to the contrary shall be null and void. The law further provides that when the insured has several policies on the same property, his recovery from any company will be pro rata as to the amount thereof.

About twenty years ago, the Supreme Court of Georgia was called upon to decide whether under the law referred to the old co-insurance clause then in use, which provided

> "that the assured shall at all times maintain a total insurance upon the property insured by this policy of not less than 75% of the actual cash value thereof . . . . and that failing to do so, the assured shall become a co-insurer to the extent of the deficiency,"

was valid and enforceable, and it decided that the clause was not violative of the law. Pekor vs. Fireman's Fund Ins. Co. (1898) (106 Ga. page 1).

The court evidently construed the clause as a binding agreement on the part of the insured to secure insurance up to a certain percentage of value, and virtually held that if the insured himself desired to take the place of another insurance company he was at liberty to do so as one way of fulfilling his agreement.

The Georgia courts, however, have not passed upon the validity of the reduced rate contribution clause in connection with the statutory law above referred to; but it is fair to assume that they will view the matter in the same light as the Tennessee court *(supra)*, and hold that it is not a co-insurance clause, even though it generally produces the same result; that it contains no provision whatever requiring the insured to carry or procure a stated amount of insurance, and in event of failure, to become a co-insurer, but that it is simply a clause placing a limitation upon the insurer's liability, which is expressly prohibited by statute. The fact that the insurers have labeled it "75% Co-insurance Clause" does not make it such.

It is, therefore, not at all surprising that the question is frequently asked as to the difference between the various forms of so-called co-insurance clauses, and these will be considered in the order in which, chronologically, they came into use.

Probably in ninety-nine cases out of one hundred there is no difference between these clauses in the results obtained by their application, but cases occasionally arise where according to the generally accepted interpretation the difference will be quite pronounced. This difference, which will be hereinafter considered, appears in connecton with the old co-insurance clause and the percentage co-insurance clause, and only in cases where the policies are nonconcurrent.

The first of the four forms is the old co-insurance clause which for many years was the only one used in the West, and which is used there still, to some extent, and now quite generally in the South. Its reintroduction in the South was probably due to the Tennessee decision, to which reference has been made *(supra)*. This clause provides that the insured shall maintain insurance on the property described in the policy to the extent of at least a stated percentage (usually 80%) of the actual cash value thereof, and failing so to do, shall to the extent of such deficit bear his, her or their proportion of any loss. It does not say that he shall maintain insurance on *all* of the property, and the prevailing opinion is that the co-insurance clause will be complied with if he carries the stipulated percentage of insurance either on all or on any part of the property described, notwithstanding the fact that a portion of said insurance may be of no assistance whatever to the blanket, or more general policy, as a contributing factor.

The following example will serve as an illustration:

Co. "A" covers $10,000 on Bldgs. Nos. 1, 2 and 3, 100% Clause.
Co. "B" covers $10,000 on Building No. 2, 100% Clause.
Co. "C" covers $5,000 on Building No. 3, 100% Clause.

Sound Value of Building No. 1, $10,000
Sound Value of Building No. 2, 10,000
Sound Value of Building No. 3, 10,000
Loss on Building No. 1, $10,000.

Under the application of the 100% average or reduced rate contribution clause, the liability of Company "A" would be 10,000/30,000 of $10,000, or $3,333.33, but under the 100% co-insurance clause its liability would be 10,000/15,000 of $10,000, or $6,666.67, and the insured would be a co-insurer for 5,000/15,000 of $10,000, or $3,333.33. Inasmuch as the $10,000 policy in Company "B" and the $5,000 policy in Company "C" do not cover on the building where the loss occurred, they, of course, can not be brought in for contribution toward paying the loss, but for the purpose of constructively meeting, or assisting in meeting, the requirements of the co-insurance clause it is contended that it is "insurance on the within-described property."

It has even been suggested that in the example above cited the insured would be a co-insurer only to the extent of 5,000/30,000 of $10,000, or $1,666.66, and that Company "A" would pay the balance of the loss, $8,333.33. To produce this result, however, Company "A's" policy would have to be transformed from one for $10,000 into one for $25,000, and this would be beyond the realm of either rhyme or reason. If it be conceded that the basis of the insured's contribution as a co-insurer can be restricted to $5,000, he must co-insure with something, and inasmuch as the only thing for him to co-insure with is the $10,000 policy in Company "A," it follows that his contribution to the loss as a co-insurer would be, as above stated, 5,000/15,000 of $10,000, or $3,333.33.

Either of the above constructions is, of course, entirely at variance with the intention of the authors of the clause, and tends to frustrate its purpose, but it appears to be the opinion of lawyers and laymen that the first of these would be upheld by the courts, and that the remedy, if any is to be had, must be sought in an amendment of the clause. A move in this direction has been made in Canada, where it has been amended by making it read:

> "The assured shall maintain insurance on the within-described property concurrent in form with this policy."

This ought to correct the defect in the old form, and probably will have that effect in Canada, but the courts of this country have given such a narrow interpretation to the

word "concurrent" that it will not do to place too much reliance upon this amendment. It is suggested that the form might be improved by inserting the word "contributing" before the word "insurance," thus making it read:

> "The assured shall maintain contributing insurance concurrent in form with this policy."

Although insurance companies are apparently content to accept the first of the above constructions of this form of co-insurance clause in the comparatively few cases that arise, yet it certainly requires no prophet to predict that if in a given case the interest of the insured should be adversely affected by said construction, the courts would experience no great difficulty in holding that although plausible and certainly not out of harmony with the phraseology of the clause, this construction could not possibly have been intended by the framers thereof. If, for instance, in the example above cited, the capital stock of the company issuing the blanket policy has become impaired, and the insured had excess insurance broad enough to cover the liability which accrued to him by reason of the operation of the co-insurance clause in the blanket policy, it is self-evident that the smaller the amount due from the insolvent blanket insurer, the greater would be the amount collectible from the solvent excess insurer; hence, it would be against the interest of the insured to have the above construction placed upon the co-insurance clause, and its most ardent advocates would not seriously expect to have it upheld in such circumstances. The clause is defective, and should be amended so as to give the blanket policy the benefit of concurrent contribution from the insured, unaffected by the existence of non-contributing specific or less general insurance. The question of amendment has, however, been duly considered by underwriters in the states having restrictive statutes, and inasmuch as the validity of the clause as it reads has been sustained by the courts of said states, it has been deemed advisable to make a change in the wording in that territory.

The second clause is known as the percentage co-insurance clause, and provides that:

> "If, at the time of fire, the whole amount of insurance on the property covered by this policy shall be less than —% of the actual cash value thereof, this company shall, in case of loss or damage, be liable for only such portion of such loss or damage as the amount insured by this policy shall bear to the said —% of the actual cash value of such property."

The authors of this clause doubtless supposed that it was an improvement upon, and that it would correct the defect

in, the co-insurance clause; but if so they were mistaken, for as a matter of fact it is not only worse than the old clause, but is positively grotesque in its discriminating effects under certain conditions. It will be noted that the limitation of liability provided for is contingent upon the whole amount of insurance on the property covered by the policy being less than —% of the actual cash value thereof. As in the case of the old co-insurance clause, in all but a comparatively few instances the result will be the same as under the more modern clauses, to wit: the average clause, or the reduced rate contribution clause, and the defect appears only where the insurance is nonconcurrent.

In the preparation of a form it is, of course, impossible to anticipate all the conditions that are liable to arise, and it cannot be doubted that the framers of this clause intended to secure to the insurers in all cases the same benefit that would accrue to them if the insured carried full contributing insurance equal to the stated percentage of the value of the property. The first sentence of the clause, however, is exceedingly unfortunate, for as it is generally construed, the entire insurance covering any portion of the property will be included for the purpose of determining whether the co-insurance condition is properly applicable, although said insurance may not contribute anything whatever toward the payment of the loss. In this respect it is subject to the same criticism as the old co-insurance clause. When the whole insurance, including the blanket and specific, the contributing and non-contributing, equals or exceeds the percentage of value specified in the clause, both operate exactly alike to relieve the insured from contribution as co-insurer; but if the whole insurance be less than the percentage specified, the percentage co-insurance clause is much less advantageous to the insured than the old co-insurance clause, as will be readily seen from an analysis of the example given above in connection with the latter clause *(supra)*. In said example, by the application of the old co-insurance clause, the insured is a co-insurer for only 5,000/15,000 of $10,000, and loses only $3,333.33; but by the application of the percentage co-insurance clause the insured loses $6,666.67, or the difference between $10,000 and the $3,333.33 collectible from Company "A."

The fault with the percentage co-insurance clause lies in the opening sentence, "If at the time of the fire the whole amount of insurance . . . . . shall be less than —% of the cash value." This makes the application of the clause (the latter portion of which is virtually the same as the average clause or the reduced rate contribution clause) absolutely contingent upon the stated percentage of insurance being carried, and in case of nonconcurrence, if the sound value be increased to the extent of only $1.00, it may make a difference of many thousands of dollars to the insured. The following example, suggested by the late W. J. Nichols,

general adjuster of the North British and Mercantile Ins. Co. will illustrate the point:

Sound Value of Building "A,"	$200,000	
Sound Value of Building "B,"	200,000	
Specific Insurance on Building "A,"	120,000	80% Clause
Blanket Insurance on Buildings "A" and "B,"	200,000	80% Clause
80% of Value of Buildings "A" and "B,"	320,000	
Loss on Building "B,"	200,000	
Blanket Insurance pays	200,000	

Although the $120,000 specific insurance on Building "A" is not involved in the loss, yet it covers on a *portion* of the property described in the blanket policy, and is a part of "the whole insurance," therefore, the whole insurance (such as it is) is not less than 80% of the value of the property, and the insured collects his entire loss of $200,000 from the blanket insurer.

Let us, however, raise the sound value of either Building "A" or "B" by a single dollar, thus making the total sound value $400,001 instead of $400,000, and what is the effect upon the fortunes of the insured? The whole amount of insurance on the property is less than 80% of the actual cash value thereof, and the insured under the conditions of the clause can collect only 200,000/320,000 of $200,000, or $125,000. Thus, the addition of $1.00 to the sound value results in a reduction of $75,000 in the amount collectible by the insured. This discriminatory absurdity is the direct and logical result of the construction which lawyers, adjusters, and companies feel constrained to place upon the percentage co-insurance clause in circumstances such as those above outlined.

This clause, under conditions similar to those under consideration has been before the courts but once, and that was in the case of the Northwestern Fuel Co. vs. Boston Ins. Co. (131 Minn. 19; 154 N.W. 513; 46 Ins. Law Journal 715). The court admitted that the question of construction was not free from difficulty, but said "In view of the rule of construction favorable to the insured, the uncertainty of the precise application of the co-insurance clause and the disfavor with which the law regards provisions for co-insurance, the trial court properly held that the condition as to co-insurance was satisfied." The loss was confined to one item, and it was held that the clause did not reduce the collectible loss because the total insurance, including the non-contributing specific insurance, was not less than the percentage named in the policy; this being confirmatory of the view generally held with respect to the clause under such conditions. The court, however, strongly intimated that if the co-insurance clause had provided for the maintenance of concurrent insurance, it might have held otherwise.

A clause which is so discriminatory in the effect of its operation, even though in a comparatively few cases, should have been thrown into the discard long ago, and given way to the reduced rate contribution clause which is the latest, best, and fairest that has appeared in the evolutionary process of the co-insurance principle.

The third clause is that which for many years has been in use in New York City, and is known as the "Average Clause." It provides that:

> "this company shall not be liable for a greater proportion of any loss or damage to the property herein described than the sum hereby insured bears to —% of the actual cash value of said property at the time such loss shall happen."

This it will be noted is substantially the same as the closing paragraph of the percentage co-insurance clause which we have just been considering, and its main feature is virtually the same as the reduced rate contribution clause, which is the fourth and last to claim our attention, and they can properly be considered together. The reduced rate contribution clause reads as follows:

> "In consideration of the rate at (and) or form under which this policy is written, it is expressly stipulated and made a condition of this contract, that this company shall be held liable for no greater proportion of any loss than the amount hereby insured bears to —% of the actual cash value of the property described herein at the time when such loss shall happen; but if the total insurance upon such property exceeds —% at the time of such loss, then this company shall only be liable for the proportion which the sum hereby insured bears to such total insurance, not exceeding the actual amount of loss to the property insured.
>
> "If this policy be divided into two or more items the foregoing conditions shall apply to each item separately."

It differs from the average clause only in the fact that it is prefaced by a consideration, and also embodies the contribution provision. The average clause was, no doubt, devised for the express purpose of correcting the defects above referred to in the two older clauses, and with the view of precluding all possibility of discrimination and misunderstanding as to intention. The thought is as clearly stated as it is possible for language to express it, so that no wayfaring agent, adjuster, broker or attorney need err in the interpretation thereof, and in this respect is an improvement on the old co-insurance clause, which some people seem to think passeth human understanding.

The name "average clause" is not a particularly appropriate one, and seems to have been copied from the marine contract. (It should not be confused with the average clause used in the West and elsewhere, and which is known in the East as the "average distribution clause.") Although the title "reduced rate contribution clause" might be applied with equal propriety to the "three-fourths value clause" or the "three-fourths loss clause" it is perhaps as good a name as can be devised to distinguish it from the "co-insurance clause." In order to apply it or the average clause, all that is necessary for its application is to ascertain the actual value of the property described in the policy, whether it be blanket or specific, and there is thus obtained a basis for determining the denominator of the fraction, and with the face of the policy as the numerator there is no difficulty in finding the limit of liability under the clause.

The authors of the average clause apparently did not deem it necessary to insert the contribution provision of the policy in the clause itself, evidently assuming that the words "shall be liable for no greater proportion of any loss" would be sufficient protection; but when the reduced rate contribution clause was prepared it was evidently deemed avisable to insert the contribution provision therein, thus emphasizing the fact, if any emphasis were needed, that it was not to be superseded by the reduced rate contribution clause.

The failure to incorporate the contribution provision in the average clause has not caused the insurers any special embarrassment during the years it has been in use, but it gave the Supreme Court of New York (Erie County) in the case of Buse vs. National Ben Franklin, *et al* (160 N. Y. Supp. 566) (1916), an excuse for holding that where co-insurance conditions are present in all policies, and the aggregate co-insurance limits of liability of all the companies is less than the entire loss, the contribution clause of the policy is not applicable. This is at variance with the rule laid down by the New York Court of Appeals in the case of The Farmers Feed Co. vs. Scottish Union & National Ins. Co., 175 N. Y. 241, and that of the Supreme Court of Wisconsin in the case of Stephenson vs. Agricultural Ins. Co., 116 Wis. 277; N. W. 19. In these cases, however, all the policies were concurrent, except that some contained the co-insurance or average clause and others did not. In the Buse case, the policies were non-concurrent as to form, and all contained the average clause and it was by reason of these facts that the court apparently felt warranted in distinguishing it from the Farmers Feed Co. case *(supra)*.

The court quoted lines 98-100 of the old standard policy, which read:

> "and the extent of the application of the insurance under this policy, or of the contribution to be made by this company in case of loss, may be provided for by agreement or condition written hereon or attached or appended hereto,"

and evidently concluded that by reason of this provision the average clause should be construed as superseding the contribution clause of the policy, especially if the necessities of the insured required such construction. If the contribution clause had been incorporated in the average clause, as it has been in the reduced rate contribution clause, the court could hardly have taken this position in the light of the Farmers Feed Co. decision. This case was not appealed, and is referred to here simply in order to direct attention to a possible weakness in the average clause in use in the State of New York. Although by a lower court, the decision is no doubt pleasing to the advocates of the so-called limit of liability rule of apportionment, inasmuch as it affords them an argument in favor of putting the rule into effect in a certain class of cases in localities where the average clause is in use.

All of these four clauses contain a provision reading as follows:

> "If this policy be divided into two or more items, the foregoing condition shall apply to each item separately."

It is said that the first co-insurance clause prepared did not contain this condition, but the underwriters taking counsel of their fears, concluded that its omission might be fatal to the carrying out of the original intention in connection with policies containing more than one item, and it was amended accordingly.

All the clauses also contain what is known as the "Waiver of Inventory and Appraisement Clause," which though varying somewhat in different sections, reads substantially as follows:

> "In the event that the aggregate claim for loss does not exceed five per cent (5%) of the total amount of the insurance upon the property described herein and in force at the time such loss occurs, no special inventory or appraisement of the undamaged property shall be required."

In some sections this percentage is limited to 2%, and in others no special inventory or appraisement of the undamaged property is required if the aggregate claim for loss is less than $10,000 (provided, however, such amount does not exceed 5% of the total amount of insurance upon the property described and in force at the time of the loss).

Many people persist in placing a wrong interpretation upon this condition, and among the number are prominent insurance agents, and even special agents and adjusters. They construe it as an absolute waiver of the co-insurance clause, evidently failing to realize that if the framers of the provision had intended it as a waiver they certainly had sufficient words at their command to so state, and would not have deliberately said something else. The clause simply says that under cer-

tain conditions no special inventory or appraisement of the undamaged property shall be required. The company may resort to any method other than this to ascertain the sound value; it may have *ex parte* estimates made; it may secure the opinion of experts; examine books of account; examine the insured under oath; insist upon the sound value being sworn to in the proofs of loss; and, finally, it may let the court decide upon the value on evidence submitted. And, if a claimant should materially understate the value in the examination or in the proofs of loss, he might and probably would invalidate his claim by reason of false swearing. This, it will be seen, is far from an absolute waiver of the condition.

In New York City several years ago, a loss of about $15,000 occurred on a large building owned by a gentleman of wealth. The insurance carried was only $400,000, and the apparent value was many times that amount. The insured evidently assumed that inasmuch as the loss was less than 5% of the insurance, the 80% average clause was inoperative, but he was told to file his proofs of loss and make affidavit as to the sound value. He hesitated, but after several months delay, proofs were filed showing a sound value of about $2,500,000, and he was under the necessity of standing about 80% of the loss himself on account of under-insurance.

Years ago, the co-insurance clause contained a provision waiving its application if the loss amounted to less than 5% of the insurance; later it was changed so as not to require a special inventory under those conditions, and still later, within the past few years, it assumed its present form. In some sections the clause used to be so phrased as not to require a special inventory or appraisement of the undamaged property if the loss was less than 5% of the *actual cash value* of the property. Under this form it would be necessary to ascertain the sound value in some way in order to determine whether or not it was necessary to find it. With the advent of the uniform rules and clauses, this form, fortunately, went into harmless disuse.

In Canada a clause is in use containing the following condition:

> "In case of loss the co-insurance clause shall not be held to apply where the total loss does neither exceed $2,500 nor 2% of the sum insured on the involved item or items of the schedule."

There would seem to be no good reason why this same provision, with possibly some modification as to amount, might not be adopted in this country.

A question of no little interest, and one which is asked quite frequently, is whether the mortgagee under the mortgagee clause is bound by the terms and conditions of the co-insurance or reduced rate contribution clause. A prominent attorney has expressed the opinion that the interest of the

mortgagee cannot be affected by the co-insurance clause unless it is made to appear in clear and explicit terms that the mortgagee agrees to be bound by the provisions of the clause as a part of his contract with the company; in other words, unless it be incorporated in the mortgagee clause directly or by reference. Another authority has expressed the opinion that the mortgagee would not be bound by the co-insurance clause as applied to the value of the property, and if applicable at all, it would apply only to the value of the mortgagee's interest; in short, that the words "value of property" would be construed to mean "value of interest." According to a third authority, the mortgagee is bound by the co-insurance clause as applied to the sound value of the property.

We have here three different opinions from high legal and lay authorities, but in July, 1915, the Appellate Division, Second Department, of the Supreme Court of New York, in the case of

Hartwig vs. American Ins. Co. of Newark (154 N. Y. Supp. 801) (Ins. Law Journal, vol. 46, page 455)

rendered a decision in which it was held that the mortgagee is bound by the terms and conditions of the 80% average clause, and on the 14th day of April, 1919, the United States District Court for the Eastern District of Pennsylvania rendered another decision to the same effect, the latter case being

Pennsylvania Co. for Insurance on Lives and Granting Annuities vs. Aachen & Munich Fire Insurance Company (257 Fed. Rep. 189, Sept., 1919), (Ins. Law Journal, page 291).

It will be noted that these decisions are in harmony with the third opinion above referred to, and according to the view of the present writer, as expressed in an address delivered by him on "The Mortgagee Clause," several years ago, they are eminently sound.

"The average, or co-insurance clause, is a part of the contract with the mortgagee himself, and when he accepts the policy with this provision therein it is his own act; he should be as much bound by it as by the amount of the policy, date of expiration, and description of the property. This imposes no hardship upon him; his interests are not placed at the mercy of third parties, and the arguments advanced against the operation of the contribution clause do not apply. He can insist upon insurance payable to himself being taken out equal to the necessary percentage of the value of the property, and thereby secure absolute protection, and it is the rule with certain large loaning institutions to insist upon this in order to meet the requirements of the clause, unless they regard their security as ample without it. If, however, extraordinary improvements or repairs are made to the building after a policy is issued, without the knowledge of the mortgagee, thereby materially increasing the value of the prop-

erty, this would be an act of the owner, by which the mortgagee would not be bound."

The phrase, "for account of whom it may concern," and its running mate, the "commission or in trust clause," have probably been in use for a century or more, yet it may well be doubted whether many of the insuring public, or in fact, any considerable proportion of those engaged in the business of fire insurance, are aware of its far-reaching effects. It certainly is not generally known that if the policy of a warehouseman or other bailee contains the commission clause he cannot first reimburse himself for his own loss from the insurance fund, but that if under-insured, whether he be legally liable or not, he must pro-rate the amount collected with such bailors as may adopt his insurance, after the loss has occurred, although he will have a lien against the amounts due the respective bailors for advances or charges, if any, that may have accrued.

If, in addition to the broad coverage created by the use of the above and kindred phrases, the policies contain the co-insurance or average clause, the insured is liable to still greater embarrassment by reason of his undoubted unintentional generosity. In the first instance he may sustain a loss by reason of the mere fact that he is under-insured, but if co-insurance conditions be present, he may sustain an additional loss by reason of the value of all property in his custody being included for co-insurance purposes, thus reducing the amount that would otherwise be collectible. This applies to a railroad company or other common carrier, a warehouseman or other bailee, also to a hotel proprietor or householder who includes in his policies the property of his guests and servants.

Several very nice questions suggest themselves in this connection. Can the entire value of the property in the possession of the warehouseman be included for co-insurance purposes under the unrestricted "trust and commission clause" in all circumstances? If claim is made for damage on any portion of the bailor's goods, or if the bailee has agreed to keep the property insured, or if for any reason he is legally liable for the loss thereon, the value must be taken into consideration. But if (1) the bailor has specific insurance of his own sufficient to cover his loss, or (2) if his goods are not involved in the loss and there is consequently no necessity of his ratifying the bailee's insurance, or (3) if the bailee has no lien against the goods for storage or advances, and no personal liability, can this value be included for co-insurance purposes? There is not, to the present writer's knowledge, any recorded case involving these questions, but some good arguments can be advanced in support of the view that the value of the bailor's goods, in some of these circumstances at least, should not be included.

The new advisory mercantile form recently adopted, both in the East and in the West, contains the restricted commission clause, which only covers goods belonging to others, provided the insured is legally liable therefor. Some difficulty may be experienced at times in determining whether or not a legal liability exists, but this new form which is intended to prevent the indiscriminate adoption or appropriation of the bailee's insurance by others should be generally acceptable to the mercantile world. Without discussing the reasons, it is suggested, in passing, that this form might be improved by adding the words, "at the time of the fire," and making it read:

> "provided the insured is legally liable at the time of the fire."

There is an admonition on the back of both the old and new standard policies which, if heeded, would save the adjusters, the brokers, the companies and the insured no end of trouble, and enable the Committee of Seventeen, apportionment experts, who were appointed several years ago to prepare a universal rule of apportionment, to adjourn *sine die*. It reads as follows:

> "It is important that the written portion of all Policies covering the same property read exactly alike. If they do not they should be made uniform at once."

Nonconcurrence is always undesirable, and it is particularly so when the policies contain the co-insurance, or average, clause. The insured may have insurance in the aggregate for an amount in excess of the sound value of his property, but may by reason of nonconcurrence be compelled to stand a portion of the loss himself. If the policies cover blanket in two or more buildings, subject to the average or co-insurance clause, and the average distribution clause is also inserted in any of the policies, it should be inserted in all.

A single illustration will be sufficient to demonstrate the possible adverse effect upon the interests of the insured when co-insurance is present in nonconcurrent policies:

	Sound Value.	Loss.	Specific Insurance.	Blanket Insurance.
Stock	$10,000.00	$8,000.00	$6,750.00	
Machinery	12,222.22	None.	3,250.00	
				$10,000.00
Total.	$22,222.22	$8,000.00	$10,000.00	$10,000.00

90% Co-insurance Clause in all policies.

90% of $22,222.22 = $20,000.00.

If there were no co-insurance clause in the policies it is evident that the loss on stock under the rule laid down in the

case of Page Bros. vs. Sun Insurance Office (74 Fed. 203; 20 C. C. A. 397), would be apportioned as follows:

	Insures.	Pays.
Specific policy	$ 6,750.00	$3,223.88
Blanket policy	10,000.00	4,776.12
Total,	$16,750.00	$8,000.00

But the liability of the blanket policy is limited by the operation of the 90% co-insurance clause to 10,000/20,000 of $8,000, or $4,000, which is $776.12 less than the amount shown in the above apportionment; hence the insured loses $776.12 by reason of the operation of the co-insurance clause in the blanket policy, notwithstanding the fact that the total insurance carried equals 90% of the total value.

If the average clause in use in the State of New York were attached to the policies, the advocates of the limited liability rule would apportion the above loss as follows:

Co-insurance limit of stock insurance,
6,750/9,000 of $8,000, $6,000

Co-insurance limit of blanket insurance,
10,000/20,000 of $8,000, $4,000

Apportioning the loss on the basis of these co-insurance limits of liability, the stock insurance would pay
6,000/10,000 of $8,000, $4,800

the blanket insurance would pay 4,000/10,000 of $8,000, $3,200

It will be seen that under the rule laid down in the Buse case the insured would collect his entire loss, whereas, under the first apportionment, he would lose $776.12. The decision in the Buse case would have greater weight if it had been rendered by the Court of Appeals instead of by a lower court; in fact, it would then be controlling in the State of New York, under the application of the average clause.

There is a popular misconception regarding the 80% co-insurance clause. Many persons have the impression that if an 80% clause of whatever form is attached to the policy they can not collect more than 80% of the loss, no matter how much insurance they may have. Nothing is farther from the truth. It is axiomatic that if the loss equals or exceeds the percentage named in the clause the insurer is liable for the entire loss up to, but of course not exceeding, the amount of insurance, and the amount collectible is not affected in the slightest degree by the co-insurance clause.

There is another thing in connection with the operation of the 80% co-insurance clause that is also axiomatic. If the loss is to be settled on an agreed percentage of the total sound value of the property (but not otherwise) the sound value may be increased or decreased to any extent that the insured may desire, and it will not alter the amount collectible from the insurers, so long as the co-insurance clause remains operative. If, however, in his desire to escape the operation of the co-insurance clause the claimant should insist upon the

sound value (and consequently the loss) being reduced to such an extent as to render the clause inoperative, it would result in his undoing, and he would collect less than he otherwise might.

The following will illustrate this point:

1.	Sound value,	$20,000
	Insurance,	10,000
	Loss 40% of value,	8,000
	80% Clause.	
	Company pays 10,000/16,000 of $8,000, or	$5,000
2.	Increase Value and Loss 40%:	
	Sound value,	$28,000
	Insurance,	10,000
	Loss 40% of value,	11,200
	80% Clause.	
	Company pays 10,000/22,400 of $11,200, or	$5,000
3.	Decrease Value and Loss 40%:	
	Sound value,	$12,000
	Insurance,	10,000
	Loss 40% of value,	4,800
	80% Clause inoperative.	
	Company pays,	$4,800

Several years ago the question arose as to whether a co-insurance rider attached to the Massachusetts standard form of fire policy violated the statute of that state prescribing such standard form and providing for adding to or modifying the provisions contained therein, and it was held that it did not, and that the co-insurance clause was permissible.

(Quinn vs. Fire Assn., 180 Mass. 560; 62 N. E. 890; 31 Ins. Law Journal 460; Mass., St. 1894, C 22, Sec. 60.)

This decision would seem to suggest the permissibility of various other riders to the Massachusetts policy under the standard policy law of that state.

In Louisiana, in the case of Simon vs. Queen Ins. Co. of America (120 La. 477; 45 So. 396), it was held that the valued policy law of that state did not prohibit the use or application of the old co-insurance clause, but since this decision was rendered the law has been changed so as to limit the application of the clause to policies covering personal property.

Is the co-insurance clause a waiver of the "other insurance" provision in the printed conditions of the policy? It is self-evident that it operates as a permit for other insurance to the amount required to make up the stated percentage of value, but it has been held that it does not supersede a provision that the policy shall be void in case of other insurance when that policy itself is for an amount in excess of the stated percentage of the value of the property (Cutler vs. Royal Ins. Co., 70 Conn. 566; 40 Atl. 529; 41 L. R. A. 159). It would, however, appear to be a harsh rule which would require

the insured to maintain insurance to the amount of a stated percentage of the value of the property, and which would render the policy void if in an honest effort to meet the requirement he should happen to exceed the percentage named, and it may well be doubted whether such a rule would be generally upheld by the courts.

This question, however, can hardly arise in connection with the average clause or reduced rate contribution clause, inasmuch as these are simply provisions restricting liability and do not specifically require the insured to maintain any stated percentage of insurance. Therefore, if the insured takes out other insurance it is quite important for him to have a permit endorsed on the policy, if it contains the average or reduced rate contribution clause, and it would be advisable for him also to have such endorsement made if the policy contains the old co-insurance clause.

It would be interesting to give further consideration to the effect which co-insurance conditions may have upon the apportionment of losses in cases of nonconcurrence, but this is a subject in itself, and beyond the purview of this paper. It is sufficient to say that the advent of co-insurance has tended to discredit in a measure all the old rules for the apportionment of losses under nonconcurrent policies, and that there is open to some inquiring mind or inventive genius of the future the opportunity of discovering what the present generation of adjusters has seemingly been unable to discover, and that is a rule which, although it may not be universally applicable, will generally serve the ends of justice under present underwriting conditions.

EXAMPLES ILLUSTRATING THE OPERATION OF CO-INSURANCE CLAUSES UNDER VARYING CONDITIONS:

EXAMPLE 1

80% Co-insurance, Average or Reduced Rate Contribution Clause

Sound value	$5,000
Insurance that the insured should carry	4,000
Insurance carried	3,000
Loss	2,000
Company pays 3000/4000 of $2000 or	1,500
Insured loses 1000/4000 of $2000 or	500

EXAMPLE 2

80% Co-insurance, Average or Reduced Rate Contribution Clause

Sound value	$5,000
Insurance that the insured should carry	4,000
Insurance carried	4,000
Loss	2,000
Company pays 4000/4000 of $2000 or	2,000
Insured loses 0000/4000 of $2000 or	Nothing

EXAMPLE 3

100% Co-insurance, Average or Reduced Rate Contribution Clause

Sound value	$5,000
Insurance that the insured should carry	5,000
Insurance carried	3,000
Loss	2,000
Company pays 3000/5000 of $2000 or	1,200
Insured loses 2000/5000 of $2000 or	800

EXAMPLE 4

100% Co-insurance, Average or Reduced Rate Contribution Clause

Sound value	$5,000
Insurance that the insured should carry	5,000
Insurance carried	5,000
Loss	2,000
Company pays 5000/5000 of $2000 or	2,000
Insured loses 0000/5000 of $2000 or	Nothing

EXAMPLE 5

Blanket policy covering in several buildings. 100% Co-insurance, Average or Reduced Rate Contribution Clause

Stock in Building A	$ 5,000
Stock in Building B	10,000
Stock in Building C	8,000
Stock in Building D	7,000
	$30,000
Insurance carried	30,000

As insurance is carried for the full value of the property there is no contribution by the insured for any loss either total or partial.

EXAMPLE 6

Blanket policy covering in several buildings. 100% Co-insurance, Average or Reduced Rate Contribution Clause

Stock in Building A	$ 5,000
Stock in Building B	10,000
Stock in Building C	8,000
Stock in Building D	7,000
	$30,000
Insurance carried	15,000
Loss in Building B	5,000
Company pays 15000/30000 of $5000 or	2,500
Insured loses 15000/30000 of $5000 or	2,500

The

Fire Insurance Policy as a Contract

A LECTURE

BY

W. N. BAMENT
General Adjuster

THE HOME INSURANCE COMPANY
NEW YORK

The Fire Insurance Policy as a Contract

William N. Bament, General Adjuster
The Home Insurance Company, New York

The seal used by the Insurance Department of the State of New York for many years contained the following inscription: *"Alter alterius onera portate"*—"Bear ye one another's burdens," and it would be difficult to conceive of a more highly appropriate motto for such a department, or a more felicitous expression with which to symbolize the underlying principle of insurance.

According to the authorities, insurance was originally held to be in effect nothing but a mere wager, and it was a matter of grave doubt whether as a principle of ethics it should be allowed, but for many years it has been regarded as the handmaid of commerce and an absolute business necessity, the gambling element being eliminated or reduced to a minimum by the fact that in order to support a valid contract the party insured must have an insurable interest in the subject thereof.

It is undoubtedly true that in the early part of the eighteenth century, in addition to the regular business of insurance, wagering contracts were issued both in England and on the Continent, covering almost every conceivable subject or event, but about the middle of the same century the issuing of wagering policies was prohibited by statute and Lord Mansfield, who may justly be regarded as the father of insurance law, rendered his famous decision making an insurable interest the basis of the contract. This put an end to the demoralizing practice and paved the way for the marvelous development of legitimate insurances, and placed the business upon the high plane where it now rests and where it is universally regarded as one of the bulwarks of our mercantile, industrial and social life.

The oldest form of insurance is marine, which was doubtless in vogue among the ancients, but did not assume anything approaching its present form until the twelfth or thirteenth century, when it was taken up by the Lombards who resided in Northern Italy. They had branches in all

the important cities of Europe and some of them settled in London, and Lombard Street, London, which takes its name from them, became in time the great marine underwriting center of the world.

It was not, however, until the great London conflagration of 1666, that people awoke to a realization of the great danger of loss by fire, and it was not until thirty years later that anything except sporadic efforts were made toward placing fire insurance upon a firm basis, but during the past two centuries it has steadily grown in public favor and is now by far the most popular of all the various departments of insurance.

Contracts of insurance, although they may be by parol, are almost universally reduced to writing in an instrument called the "policy," which word is most probably of Italian derivation and signifies a promise or a note or memorandum in writing.

In addition to the necessity of an insurable interest, there are a number of other elements essential to a legitimate contract of insurance; it is primarily a contract of indemnity; it requires the utmost good faith on the part of all parties thereto; there must be a risk which may result in a real loss which neither party has the power to avert or hasten, and it is incumbent upon the insured to communicate to the insurer all facts material to the risk.

In order to constitute an insurable interest, the insured must be so circumstanced with respect to the property subject to loss or damage by fire, that he may be benefited by its safety or prejudiced by its destruction, and this includes a great variety of relations.

The following interests may be mentioned as insurable: An owner, in whole or in part, of the property; a vendor and vendee under an executory contract of sale; a mortgagee; a remainderman; a lessee in improvements to the building or land or in his profit on the lease, or one who has obligated himself to restore the property or to pay rent; a landlord in the rents or rental value of the property; a warehouseman or bailee in advances or charges, or on his assumed liability; a common carrier on its liability; an owner in his profits; a merchant or manufacturer in the use and occupancy of his store or plant. A right to future possession, or a future interest, no matter how improbable its attainment, will support an insurable interest, whereas a mere expectancy, no matter how probable its realization, will not, although recent decisions by certain courts in this country seem to indicate some departure from this time-honored priniciple.

A policy of insurance is an aleatory contract in the sense that it embodies the element of chance and is contingent upon some event which may or may not occur. It is a reciprocal contract in that it involves mutual obligations.

It is a voluntary contract whether it be a form prescribed by the state or not, and when issued by the insurer and accepted by the insured, both are bound by its provisions. It is a personal contract and does not follow the property nor pass with the title unless assigned with the consent of the insurer. The personal nature of the contract becomes increasingly evident when it is realized that it is not property as such which is insured, but the individual, although the words "property insured" by reason of continuous use, have become an insurance idiom. It is a conditional contract and its validity depends upon its conditions being complied with. This is necessarily so for the reason that for a comparatively small consideration, the insurer may be called upon to pay a large amount, and because the contract is designed to cover every conceivable class of property and protect virtually every interest known to the commercial world.

The policy must protect the insurer against material misrepresentation, abandonment of property, over-insurance, over-loading of buildings, extravagant claims, increase in risk and moral hazard, both before and after a loss, for inasmuch as many fires are welcomed if not desired, if a moral hazard does not exist before, it not infrequently develops after a loss has occurred. It is on this account and because insurance companies deal with all sorts and conditions of men that the standard policy in current use, contains provisions exempting the insurer from liability for any one of a dozen or more sins of commission on the part of the insured, and for any one of an equal number of sins of omission, and provides that the company shall not be liable for loss caused in a dozen different ways, nor for loss on eight classes of property under any circumstances, nor for loss on about a score of others unless liability is specifically assumed thereon. Fortunately for the public, insurance companies do not always stand upon their technical rights, but on the contrary, are disposed to view all meritorious claims in a spirit of the broadest liberality. It is doubtful if one person in a thousand ever reads his policy, especially the printed conditions, but it is not the only well-known piece of literature relating to protection from fire, that people ought to read but do not.

The adoption of a standard fire policy by the State of New York in 1886, marked a great advance in the insurance contract. The ornate policies in use prior to that time, with no uniformity in conditions, with their classification of hazards, which few could understand, and their fine print, which no one not possessing unusually acute vision could read, gave way to the plainly printed uniform policy, which materially simplified conditions, which was adopted either verbatim or with slight modifications by other states, so that it is probably safe to say that for the past thirty years, fully seventy-five per cent of all the policies issued, outside of the states having standard policies of their own, have been the New York

Standard. Although this has not resulted in uniformity of decisions, it has had the effect of materially restricting litigation and has been of incalculable benefit both to the insurer and the insured. A new standard policy is to go into effect in New York January 1, 1918. It has already been adopted by several states and will no doubt be by others in the not distant future. From time immemorial it has been the uniform practice of the courts to construe the insurance contract most liberally in favor of the insured as against the insurer in accordance with the general rule that the contract should be construed most strictly against the one by whom it is prepared. The standardizing of the policy by the legislatures of the various states has neutralized this tendency to some extent, but the courts can safely be relied upon to prevent forfeiture if it can be done without undue violence to the plain intent of the contract.

Insurance companies are not inclined to resist the payment of claims, but on the contrary, they sometimes approach the extreme limit of propriety, generosity and good morals, in their efforts to avoid litigation. This is evidenced by the fact that of all the losses which occur, probably not more than one-fifth of one per cent become the subject of litigation, and one-half of these are settled before the cases come to trial. To put it another way, out of all the policies issued, the courts are not called upon to adjudicate claims under more than one out of every thirty thousand, which may be regarded as quite a favorable commentary upon the mutual fairmindedness of the companies and the insuring public.

Too great emphasis cannot be laid upon the contractual nature of the policy. By accepting it the insured, in the absence of mutual error, which, of course, can be corrected, becomes bound by all the descriptions, representations, warranties and conditions, written or printed, contained therein. Every property owner should read his policy, the written portion, in order to see that everything he desires covered is mentioned therein, and that the description, location, amount and dates are correct; and the printed portion, in order to obtain information with regard to his duties and obligations. He should comply with all conditions of the contract and be in a position, when a loss occurs, to demand as a right, and not to receive as a matter of grace, payment from the insurer.

An analysis of the conditions of the contract will be impossible at this time. It will be sufficient to say that the new standard policy before its adoption, received the most careful consideration at the hands of insurance commissioners, legislative committees and the best minds in the fire insurance business, and it is fair to conclude that it contains no provisions, except those which years of experience have demonstrated to be absolutely necessary to the safe conduct of the business and to the support of a wise public policy.

Although all enterprising insurance companies, agents and brokers make a practice of notifying their customers of the expiration of their policies, they are under no obligation so to do; hence, the insured should not only keep careful watch over his expirations, but he should see that his insurance is renewed several days before the policies expire. The insurance text writers and the courts which have passed on the subject, few in number though they be, have held to the view that the occurrence of a loss is synchronous with the fire actually reaching the property described in the policy. Hence, if a fire or conflagration starts in neighboring property some time before noon, the insurance expiring at noon, and the fire, or the smoke, heat or water therefrom, does not reach the premises until after noon, the owner will be compelled to suffer the consequences of his own neglect if he has failed to renew his policies. (Insurance Co. vs. Peaslee-Gaulbert Co., [Ky.], 34 Ins. Law Journal, 740).

This question as to when a loss occurs, in circumstances such as those above outlined, arose at Baltimore and San Francisco, but fortunately for the parties insured, in both instances the insurance had either been renewed in the same companies or replaced in others so that they sustained no loss. The claims were paid under the new policies. Of course, if a fire breaks out in the described premises, and continues to burn thereafter until the property is totally destroyed, it is deemed one event and the entire loss is one occurring within the terms of the policy.

A number of years ago, before the days of the telephone, a merchant in a western city, started from his place of business in the suburbs to renew the insurance on his packing house, amounting to $100,000 which was to expire that day at noon. He was unexpectedly delayed and when approaching the insurance center, the fire bell rang. He supposed it was tolling the hour of noon, but it was sounding the death knell of his business career. It was quarter past twelve, his plant was on fire and burned to the ground. And this is only one of many instances of a similar nature which have occurred in the past and which will occur in the future. The insured cannot transfer to the shoulders of others the responsibilities which properly belong to his own.

When it is considered that a very large majority of all the property in this country, of every kind and nature, is protected by insurance, that about thirty million fire insurance policies are issued annually, upon which the premiums amount to nearly half a billion dollars, that the losses thereunder are nearly sixty per cent of that amount, that these policies furnish collateral for loans on about sixty per cent of all the real estate in the country, and form the basis of our commercial credit, we can realize that of all the forms of contract in current use, there is none more indispensible to the business world than the contract of fire insurance.

What is a Fire Loss?

Direct and Consequential Loss

AN ADDRESS

DELIVERED BEFORE THE NINETY-EIGHTH
MEETING

OF

The Insurance Society
of New York

November 24th, 1914

BY

W. N. BAMENT

General Adjuster

THE HOME INSURANCE COMPANY
NEW YORK

What is a Fire Loss?

When Prometheus brought to earth as a gift to man the fire he had stolen from the chariot of the sun, he could never, even with his superhuman attributes, have imagined its possibilities of destruction as evidenced by wars and conflagrations, or the magnitude and far reaching effect of its benefits, which have their practical manisfestation in the arts and sciences. Nor could he have even dimly pictured as one of the results of his benefaction the great business of fire insurance, which, after an evolutionary process of over two hundred years, may in The Insurance Society of New York, be said to have reached its apogee.

It is said that human culture began with the utilization of fire, and that culture increased in the same ratio as its use. The ancients, the barbaric tribes, and even our forefathers were interested in how to produce and preserve it; we are chiefly interested in how to control and prevent it. It was an element in the national and religious ceremonies of the ancient Egyptians, the Greeks, Romans and Persians, and among the aboriginal tribes of America. From the dawn of civilization, and even before, the human race has been more or less familiar with fire and its phenomena, yet the question, "What is a fire?" has claimed the consideration of scientists, lawyers, courts and juries, and possesses enough elements, if not of doubt, yet certainly of interest, to command the studious attention of all those engaged in the business of fire insurance.

To constitute "fire" within the meaning of a policy of fire insurance, two requisites are necessary. First, there must be actual ignition, evidenced by a flame, glow, or something resembling luminosity. Second, the fire must be, so far as the insured is concerned, accidental in its origin. Hence a fire in a stove, grate or furnace, no matter how intense it may become, or the flame of a lamp, oil stove or gas jet no matter how high it may rise, so long as it is confined to the place where it is intended to be, is not a fire within the meaning of the contract. A fire of this character is denominated "friendly" as distinguished from "hostile," and any loss caused by smoke, heat or soot from such fire, or by the burning of property therein, is not covered by the policy.

If, however, such friendly fire extends beyond the place intended and provided for it, and causes ignition outside its proper limits, there is at once an independent fire, fortuitous in its origin, and hostile in its nature, and any loss resulting therefrom, whether by direct burning, smoke or heat, comes within the protection of the policy.

A contract of fire insurance differs from ordinary contracts in that it is based upon an event which is possible or liable, but not certain, to occur. Its very essence is embodied in the words "casualty," "accident," "chance," "contingency." The insurer undertakes, for a comparatively small premium, to guarantee the insured against loss upon the happening of a certain event, and the contract implies the utmost good faith. If, therefore, the insured intentionally sets fire to his property he thereby violates the essential principle of the contract, and even in the absence of a special stipulation, there can be no recovery. And it is not necessary that any indictable offense be shown in order to prevent recovery for the willful burning of the property. (Schmidt vs. New York, etc. Ins. Co., 1 Gray [Mass.] 529).

Recently a man was tried on the charge of having willfully set fire to his property. The jury disagreed by reason of the fact that the accused on the stand, evidently upon the advice of counsel, made the remarkable statement that he had no motive for burning the property because the premises had been vacant for more than thirty days, and therefore his insurance policy, which was for several thousand dollars, was null and void.

Where, as in some of the older forms, the policy contained a stipulation that the company would be discharged from the payment of loss caused by gross negligence, and it having been proved at the trial of the case that the fire did occur from such cause, the insurer was not held. (Campbell vs. Monmouth Mut. Fire Ins. Co., 59 Me. 430; 5 Bennett 395).

The general rule is that carelessness or negligence of the insured, his agents and servants, in the absence of a special stipulation, affords no defense. Aside from the difficulties in the way of determining the degree of negligence which would be sufficient to cause forfeiture, negligence is a well known human characteristic, and a different rule would practically defeat the chief purpose of insurance. (Waters vs. Merchants' Louisville Ins. Co. 11 Pet. [U. S.] 213; 1 Bennett 615).

On the other hand there is good authority in favor of the doctrine that grave misconduct on the part of the insured or his responsible agent of so pronounced a character as to evince a fraudulent purpose, a corrupt design, or a culpable recklessness and indifference to the rights of others, or the omission to do that which good faith requires that he should do, would warrant a verdict excusing the insurer from liabil-

ity. For instance, if the premises should take fire and the flame begin to kindle in such a small way that a cup of water would put it out, and the insured having water at hand should neglect to use it; or where the insured, in his own house, sees the burning coals in the fire place roll down on his wooden floor, and does not brush them up; or if the insured not only neglects to save the property himself but attempts to prevent others from saving it, the loss has been held to fall upon the insured and not upon the insurer. (Thornton vs. Security Ins. Co. [C. C.] 117 Fed. 773; Chandler vs. Worcester Mut. Fire Ins. Co., 3 Cush. [Mass.] 328; Ellsworth et al. vs. Aetna Ins. Co. 89 N. Y. 186; Fleisch vs. Ins. Co. of N. Am. Mo. App. 589; Aurora Fire Ins. Co. vs. Johnson 46 Ind. 315—326; Cin. Mut. Ins. Co. vs. May 20 Ohio 211). Ostrander on Ins.

There is quite a conspicuous absence of consistency in the decisions bearing on this question. For example, the insured, the owner of a steamboat, while racing with another boat placed a barrel of turpentine near the opening in the furnace, intending to use it for fuel, and as a consequence the steamer was destroyed by fire. His conduct was not willful, yet the Court held that there could be no recovery. (Citizens Ins. Co. vs. Marsh 41 Pa. St. 386). On the other hand, where an ice house was destroyed by the spread of a fire which had been made by the president of the plaintiff corporation, not far from the building, for the purpose of burning some rubbish, and which had been left burning without any one to watch it during the noon hour, the insurer was held liable. (Des Moines Ice Co. vs. Niagara Fire Ins. Co. 99 Iowa 193; 68 N. W. 600).

Every insurance company has numerous instances each year where negligence is quite as pronounced as in either of the above cases, and no one in these days ever thinks of contesting them. It is probably no exaggeration to say that a majority of all the fire losses which occur are directly chargeable to negligence of some kind on the part of the insured, his agents or servants.

The New York standard policy contains a condition making it incumbent upon the insured to use all reasonable means to save and preserve the property at and after a fire, or when the property is endangered by fire in neighboring premises, although it has been held that such a provision does not impose any additional duty upon the insured because it is clearly his duty to do this without any express provision in the policy. Cincinnati Mut. Ins. Co. vs. May 20 Ohio 211, [supra] Gardere vs. Columbian Ins. Co., 7 Johns R. 514 [N. Y.]. It is, however, the almost universal custom for the insured, his man servants, his maid servants, and everybody else, to lose their heads in the presence of fire, and do those things which they should not do, and leave undone those things which they should do, and although there are a few cases

on record of such a flagrant nature that the insurers were excused (supra), it is seldom that a case of misfeasance or nonfeasance occurs sufficiently pronounced to induce a jury to exempt the insurers from liability.

If the insured burns his property while insane, his irresponsible act is no bar to recovery. (Karow vs. Continental Ins. Co. 57 Wis. 56; 15 N. W. 27; 46 Am. Rep. 17). The act of a third party in setting fire to the property whether unintentional, careless or criminal, or that of an agent of the insured while acting outside the scope of his authority, will not relieve the insurer from liability unless the burning was with the privity or consent of the insured. Likewise, the intentional burning of the property of the husband by the wife, or that of the wife by the husband, or that of the father by the son will afford no defense to the insurer. (Walker vs. Phoenix Ins. Co. 62 Mo. App. 209; Mickey vs. Burlington Ins. Co. 35 Ia. 174; Grove vs. Ins. Co. 48 N. H. 41; Perry vs. Mechanics Ins. Co. 11 Fed. 485; Plinsky vs. Germania Ins. Co. 32 Fed. 47; Feibelman vs. Manchester Assurance Co. 108 Ala. 180; Henderson vs. Western Ins. Co. 10 Rob. [La.] 164; Malin vs. Mercantile Town Mut. Ins. Co. 105 Mo. App. 625.) Richards on Ins.

There is on record a foreign case where a piece of jewelry was accidentally knocked from a mantelpiece into the fire below and it was held to be a direct loss by fire. (Paris Law Courts, 22 Irish Laws and Solicitors, Jl. 169). It is submitted that this ruling is unsound. It is true the fall of the jewelry was accidental, and it dropped into a place where it was not intended to be. The fire, however, was not accidental, and remained where it was voluntarily placed. It was a friendly fire performing its duty as such, and it did not become any the less friendly or acquire any of the elements of a hostile fire because a piece of more than ordinarily expensive and less combustible fuel was added to the flames. No independent hostile fire was created, any more than one would be by the throwing into the grate of another piece of wood or shovelful of coal. The fire itself must be accidental in order to bring the loss within the protection of the policy.

Some analogy may be drawn between those cases where jewelry and other articles fall or are inadvertently thrown into a grate or furnace, and the familiar and frequent ones where clothing falls upon a red hot stove, or where a lace curtain blows or is pushed against a gas jet. The analogy is slight and ends with the accidental nature of the contact. When the clothing touches the stove, or the curtain the gas jet, another fire is started, entirely independent of that in the stove or the gas burner. The second fire thus created is hostile, and not being confined to the limits within which fire is intended to be, the loss is one for which the insurer is liable.

Where the heat from escaping steam is so great as to cause charring, but without ignition, there is no loss within

the meaning of the policy. (Gibbons vs. German Ins. & Sav. Inst. 30 Ill. App. 263). Although certain chemical actions may correspond in their effects to fire, they do not constitute fire unless they result in actual ignition. Mere combustion will not support a claim for loss by fire, unless it is sufficiently rapid to produce ignition. (Western Woolen Mills Co. vs. Northern Assurance Co. 139 Fed. 637; 72 U. S. C. C. A. 1). Although lightning may be a form of fire, loss caused by lightning, without actual ignition, is not in the ordinary meaning of the words, a loss by fire; but a "lightning clause" may be, and usually is, attached to the policy.

The ablest and most interesting exposition of the question as to what is meant by "fire" within the meaning of a contract of fire insurance is that contained in the opinion of the United States Circuit Court of Appeals, 8th Circuit, in the case of Western Woolen Mills Co. vs. Northern Assurance Co. 139 Fed. Rep. 637, 82 U. S. C. C. A. p. 1 which may be briefly stated as follows: A large quantity of wool in fleeces was submerged for eight days during a flood, which caused spontaneous combustion, with smoke, steam and great heat by which the wool was damaged and its fibre destroyed. The building did not burn, nor did any part of it. The wool was spread to dry and was stirred with pitchforks day and night, as it was too hot for handling, though not hot enough to blister one's hands. The wool was at all times wet, but at no time was there any visible evidence of what is popularly known as fire.

The Court said, "Spontaneous combustion is usually a rapid oxidation. Fire is oxidation which is so rapid as to either produce flame or a glow. Fire is always caused by combustion, but combustion does not always cause fire. The word "spontaneous" refers to the origin of the combustion. It means the internal development of heat without the action of an external agent. Combustion or spontaneous combustion may be so rapid as to produce fire, but until it does so, combustion cannot be said to be fire."

"No definition of fire can be found that does not include the idea of visible heat or light, and this is also the popular meaning of the word. The slow decomposition of animal and vegetable matter in the air is caused by combustion. Combustion keeps up the animal heat in the body. It causes the wheat to heat in the bin and in the stack. It causes hay in the stack and in the mow of the barn to heat and decompose. It causes the sound tree of the forest, when thrown to the ground, in the course of years to decay and molder away until it becomes again a part of Mother Earth. Still we never speak of these processes as fire. And why? Because the process of oxidation is so slow that it does not produce a flame or glow." Held that the loss was not the result of fire within the meaning of the contract.

The above opinion was rendered by one of the highest courts in the land, after a careful study and consideration of the testimony of a large number of scientific experts, yet a Kansas judge in another case in the State Court growing out of the same fire, had such an exalted opinion of the intelligence of a Kansas jury that he deemed it unnecessary to give any definition of what constitutes "fire," and the jury, as was to be expected, proceeded to show its entire ignorance of the subject by rendering the customary insurance verdict, which the divided higher court, in a semi-apologetic opinion, refused to disturb. (Western Woolen Mills Co. vs. Sun Insurance Office, 72 Kan. 48; 82 Pac. Rep. 513).

In a case where the building was heated by steam, which by the breaking of a pipe escaped into a room, damaging books and furniture and causing such intense heat as to result in charring and otherwise severely damaging the contents of the room, the Illinois Appellate Court said: "Fire and heat are not one, but cause and effect. Damage by heat is not insured against in terms, and is covered by the policy only where the misplaced fire causes it. If fire were a moral agent, no blame could be imputed to it. It was doing its duty, and nothing more. The damage was caused by another agent, who, undertaking to transmit the beneficial influence of the fire, broke down in the task. The common understanding of the word "fire" would never include heat, short of the degree of ignition." (Gibbons vs. German Ins. & Sav. Inst. 30 Ill. App. 263).

Perhaps the most famous and the most frequently quoted decision bearing on this subject is that in the English case of Austin vs. Drewe, decided in 1816 (4 Campbell 360; 6 Trant 436). The property covered was the stock and utensils in a sugar house. The building was eight stories in height, and in each story sugar, in a certain stage of preparation, was deposited for the purpose of being refined; this required a certain degree of heat, and this was communicated to each story by a chimney running up through the whole building and forming almost one side thereof. At the top of the chimney, above the eight stories, was a register, which the plaintiffs used to shut at night in order to retain in the chimney and building all the heat they could. One morning a servant neglected to open the register, and shortly afterward it was discovered that sparks and smoke had gotten into the rooms; that heat had slightly blistered the walls and accidentally discolored and damaged the sugars. There was no fire in the building that ought not to be there; nothing was on fire that ought not to be on fire: the damage was occasioned by sparks, heat and smoke. The jury found for the defendant, and the verdict was sustained on appeal, the Court holding that the loss was occasioned by the unskillful management of the machinery and register by the plaintiff's own

servants; that it was not caused by fire within the meaning of the policy, and the insurer was not liable.

The smoking lamp figures quite extensively in the experience of every fire insurance adjuster, but all the decisions which have been rendered in cases of this nature are in favor of the insurer. Two cases which may be mentioned as directly in point are Fitzgerald vs. German Amer. Ins. Co. (62 N. Y. Supp. 824; 30 N. Y. Misc. 72) and Samuels vs. Continental Ins. Co. (2 Pa. Dist. Ct. 397). The former was an ordinary smoking lamp damage, there being no fire outside the lamp itself. In reversing a judgment for the plaintiff the Court said: "The rule seems to be that where the insured employs fire for economic or scientific purposes, and the fire is confined to the agencies so employed, and damage ensues, without any actual ignition to the property insured, the insurance company is not liable." The latter case was an extraordinary smoking lamp damage, the flame having risen two or three feet above the chimney, but it ignited nothing outside of the lamp. Held, that the insurer was not liable.

This doctrine is eminently sound, and if it were otherwise, there would be no escape from liability on the part of insurance companies, for the expenses of redecorating tens of thousands of ceilings in dwelling houses alone which are blackened or otherwise discolored each year by smoking gas jets, which expenses would almost, if not entirely, absorb the modest premiums collected on that class of property.

In Massachusetts, claim was made for damage to walls and furnishings by smoke from burning soot in a chimney. There was no fire except in the stove and in the chimney. The Court seems to have had some difficulty in reaching a conclusion, but finally decided, and rightly, that the blaze in the chimney was a hostile fire independent of the friendly fire in the stove, and that the insurer was liable, using the following language: "A chimney is not intended to be used as a place in which to kindle fires. It is intended to carry off the products of combustion. We are inclined to the opinion that a distinction should be made between a fire intentionally lighted and maintained for a useful purpose in connection with the occupation of a building, and a fire which starts from such a fire without human agency, in a place where fires are never lighted nor maintained, although such ignition may naturally be expected to occur as an incident to the maintenance of necessary fire, and although the place where it occurs is constructed with a view to prevent damage from such ignition." (Way vs. Abingdon Mut. Fire Ins. Co. 166 Mass. 67; 43 N. E. 1032).

By parity of reasoning, although the insurer would not be liable for loss caused by smoke and soot from a lamp or an oil stove, so long as the flame is confined to the wick, no matter to what height it may extend, yet if it gets outside of the wick and envelopes the lamp or stove itself, the insurer

would be liable for the ensuing loss, for the reason that the fire then gets outside of the place where it is intentionally lighted, loses its friendly nature and becomes hostile.

A case bearing directly on this point is that of Collins vs. Delaware Ins. Co. (9 Pa. Super. Ct. 576). The damage was caused by fire in an oil stove, and it was left to the jury to determine from the conflicting testimony whether the fire was confined to the wick or spread to the oil reservoir. The verdict was for the plaintiff, the Court having charged the jury that if the loss was due to smoke or heat caused by fire while in its proper place in the stove, the insurer would not be liable, but that if the loss was caused by a fire outside its proper place they should find for the plaintiff.

A case differing in an essential particular from that of Way vs. Abingdon Mut. Fire Ins. Co. (supra), but possessing some points in common, is that of Cannon vs. Phoenix Ins. Co. (110 Ga. 562). The policy covered on a stock of dry goods, hats and clothing. A stovepipe became disconnected at the ceiling, and when a fire was built in the stove, the smoke and soot damaged the goods in the upper story to the extent of several thousand dollars. Water was used quite freely to cool the ceiling, but there was no evidence that there was any fire except in the stove where it was intended to be. Held, that the insurer was not liable.

The insurer is not liable for damage caused by an exploding steam boiler, where there was no fire except under the boiler; nor for damage to a boiler by overheating from regular furnace fires, owing to the absence of water in the boiler. (Millandon vs. New Orleans Ins. Co. 4 La. Amn. 15; American Towing Co. vs. German Fire Ins. Co. 74 Md. 25; 21 Atl. 553).

Recently, in Pennsylvania, a large manufacturing concern after having its furnace cleaned, had kindling placed therein preparatory to getting up steam when the factory opened for business the following morning. The water had been drawn off from the boiler, and the manhole left open. It was claimed that a stranger, or some one who had no right to do so, set fire to the kindling, which resulted in a damage of several hundred dollars to the boiler and setting. The claim, rightly or wrongly, was allowed on the theory that with respect to the insured the fire was hostile, for the reason that although a furnace is ordinarly intended to hold fire, it is not intended that a fire which needs watching should be lighted indiscriminately by strangers at any time, and certainly not irrespective of conditions. If this fire had been lighted by the insured or any one of his employees while acting within the scope of his authority, the claim would not have been recognized, notwithstanding the fact that the boiler was not in condition to withstand the effects of the fire.

A decision directly in point (not yet reported) has just been handed down by the Supreme Court of Kansas in the

case of McGraw, Trustee, vs. Home Insurance Company. It was alleged that some unknown person gained entrance to the laundry, drained the boiler, turned on the natural gas, kept the fire going until the boiler was destroyed and then turned off the gas and retired from the building. The court while admitting that under such a state of facts the fire would doubtless be regarded as hostile and the insurer held liable, concluded that the theory advanced presented features of such inherent improbability that it ought not to be adopted except upon evidence tending to exclude any more reasonable hypothesis. As no such evidence was presented the court decided that an inference of malicious injury by an outsider was not fairly deducible, and held that the insurer was not liable.

Where the insured places anything on a stove for the purpose of cooking, heating or warming, and the stove becomes overheated, causing the article to become charred and give off an oily or greasy smoke which damages the building and contents, it has been held that the insurer is not liable.

There is but one discordant note to mar the harmony of these decisions, and that comes from Wisconsin. A servant built a fire in the furnace with paper and cannel coal, not used or intended to be used for such purpose, and in a short time the fire, which was confined to the furnace, became so violent as to fill the house with smoke, soot and intense heat, resulting in a damage of several hundred dollars to the property. The Wisconsin Supreme Court, one justice dissenting, held that the fire was extraordinary and unusual, unsuitable for the purpose intended, and in a measure uncontrollable, besides being inherently dangerous because of the material used. The fire was accordingly declared hostile within the contemplation of the policy, and the insurer held liable. (O'Connor vs. Queen Ins. Co. 140 Wis. 388).

This is the only court which has varied from the time-honored principle that the insurer is not liable for loss caused by a so-called friendly fire. There was a strong dissenting opinion, but the fire in the furnace was so unusual and the heat so intense that the majority of the court could not, apparently, refrain from arguing itself into the belief that it had lost its friendly nature and should be regarded as hostile.

Singularly enough, no claim for loss by heat or smoke from a bonfire has ever been before the courts for adjudication, probably because losses of this nature are usually small. The word "bonfire," viewed in the light of its possible etymological significance, seems friendly, but whether it be derived from the French or not—and this is open to question—a bonfire is anything but a good fire. Inasmuch, however, as the civil authorities, fire departments, property owners and the long suffering community make no objection to these fires being kindled, and put forth no effort to extinguish them,

this may be taken as presumptive evidence that they are looked upon by the public generally as friendly, and it would certainly seem that they should be so regarded, at least with respect to those who intentionally light them, if not with respect to others.

Although the insured must show that he has sustained a loss by fire within the meaning of the policy before he can recover against the insurers, it is not necessary for him to show that the property injured has actually been burned by the fire. It is sufficient if he proves that the fire was the proximate, that is, the dominant, efficient cause of the loss. For example, the insurer is liable for damage by smoke, by water used to extinguish the fire, by the operations of firemen and others, by falling walls, by exposure during the fire, or by reasonable removal; also damage by explosion when explosion is caused by fire; also loss by theft, or injury caused by intentional blowing up of building by the civil authorities to prevent the spread of a conflagration, unless there are express stipulations to the contrary in the policy.

Damage caused by a fire engine on its way to a fire is not a loss coming under the protection of the policy (Foster vs. Fidelity Ins. Co. 24 Pa. S. Ct. 585); nor damage caused by a fire department which breaks into a building under the mistaken assumption that a fire is in progress; but losses of the latter description are usually small and there is a general inclination on the part of the insurers to give them favorable consideration.

An explosion caused by an explosive substance such as gunpowder coming into contact with fire, is strictly speaking, a fire of inconceivable rapidity, though it can hardly be considered fire in the popular sense. But many of the older decisions held that the ignition of gunpowder constitutes fire within the meaning of a policy of fire insurance, and doubtless on account of these decisions the insurers inserted the condition exempting themselves from liability for loss caused by the explosion of gunpowder, camphene, or any explosive substance, and later the clause as it appears in the standard policy, which expressly declares that the company shall not be liable for explosion of any kind unless fire ensues, and in that event, for the damage by fire only.

The most famous among the older cases bearing on this subject is that of Scripture vs. Lowell Mut. Fire Ins. Co. decided in 1852, 10 Cush. (Mass.) 356; 57 Am. Dec. 111. The tenant's minor son carried a cask of gunpowder into the attic of the building without plaintiff's consent, and fired it with a match. The gunpowder exploded, set fire to a bed and clothing, charred and stained some woodwork and blew off the roof of the house. The Court held that the entire damage by combustion and explosion was covered by the policy.

The question as to what is the legal test of the existence of casual relation is one concerning which there is a great diversity of opinion. Philosophers, metaphysicians and logicians for centuries have busied themselves with the subject; the philosophers and logicians differ with the jurists, and the jurists differ with each other; and in no branch of business have we more striking or more interesting illustrations than in that of fire insurance.

From the numerous definitions of proximate cause which have been given, the following is taken from an opinion rendered by our highest court: "The question is not what cause was nearest in time or place to the catastrophe. That is not the meaning of the maxim, *causa proxima non remota spectatur*. The proximate cause is the efficient cause, the one that necessarily sets the other causes in operation. The causes that are merely incidental or instruments of a superior or controlling agency are not the proximate causes and the responsible ones, though they may be nearer in time to the result. It is only when the causes are independent of each other that the nearest is, of course, to be charged with the disaster." (The G. R. Booth, 171 U. S. 450).

One of the most celebrated cases, outside of insurance, involving the question of proximate and remote cause, is one recorded in Blackstone (2 Wm. Blackstone 893; 3 Wilson 403) which is familiar to all law students, that of Scott vs. Shepherd, familiarly known as the "Squib case." Blackstone dissented and the majority of the Court reached their conclusions along different lines of reasoning. The defendant, a lad, threw a lighted squib or serpent made of gunpowder, from the street into the market house, where a large concourse of people were assembled. The lighted squib fell upon the stand of one Yates, where ginger bread, cakes and pies were sold. To prevent injury to himself and the wares of Yates, one Willis instantly took up the squib from the stand and threw it across the market house, when it fell upon another stand of one Ryal, who sold the same sort of wares. Ryal instantly took up the squib to save his own goods and threw it into another part of the market house. In its passage it struck the plaintiff in the face, and bursting, put out one of his eyes. A recovery of £100 by the plaintiff was sustained by the English Court of Common Pleas.

This seemingly far fetched though perhaps logical decision has a parallel in a well known insurance case, to wit: Lynn Gas & Electric Co. vs. Meriden Fire Ins. Co. 158 Mass. 570, 33 N. E. 690, 29 L. R. A. 297, 35 Am. St. R. 540. A fire occurred in the tower of a building through which electric light wires were carried. The fire was confined to the tower, and the damage there was slight, but it caused a short circuit which resulted in bringing into the dynamo below an increase of electric current. This caused a greater resistance to the machinery, which was transmitted to a pulley through a belt

so that the shock destroyed the pulley. By the destruction of that pulley the main shaft was disturbed and the succeeding pulleys up to the jack pulley were ruptured. By reason of pieces flying from the jack pulley, or from some other cause, the fly wheel of the engine was destroyed, the governor broken, and everything crushed. This general disruption occurred in a part of the building remote from any fire and the Court held that the whole loss was by fire within the meaning of a Massachusetts standard policy.

Both of the foregoing decisions are in quite striking contrast to that rendered by the New York Court of Appeals in the familiar case of Ryan vs. New York Central & Hudson River R. R. Co., 35 N. Y. 210 (1866), which is very frequently referred to, and in not particularly complimentary terms, in connection with the question of proximate and remote cause. The Court, actuated to a great extent, apparently, by considerations of public policy, ruled in substance that recovery could be had from the Railroad Company only for the burning of the first building ignited, and that it made no difference that the burning of the second building was a probable consequence of the burning of the first. This view, which is unsound in principle, and which is opposed to an overwhelming weight of authority, has been somewhat modified in later decisions by the Court of Appeals. Hoffman vs. King, 53 N. E. 401; Webb vs. R. R. 49 N. Y. 420.

The same strong inclination on the part of New York's highest Court to discover some new and wholly independent cause intervening between the original cause and the ultimate effect, as revealed in the above cases, is apparent in the celebrated insurance case of Hustace vs. Phenix Ins. Co., 175 N. Y. 292, 67 N. E. 592, where the loss was caused solely by concussion due to an explosion from a hostile fire in the Tarrant Building, fifty-six feet and eleven inches distant, and separated from it by two buildings and an alleyway. The Court of Appeals in this case, one Justice dissenting, reversed the unanimous decision of the court below and held that the loss was not by fire but by explosion, and that the insurer was not liable.

This decision has been quite severely criticised, but it seems to be in entire harmony with those in other states where similar conditions have been under consideration; in fact there does not appear to be a single case of concussion damage on record where the insurer has been held liable under the standard policy or under any policy containing the explosion exemption clause.

But, in a case decided by the United States Supreme Court (Insurance Co. vs. Tweed, 7 Wall [U. S.] 44), an explosion occurred in a certain warehouse. The fire which followed crossed the street and communicated to a mill, and from there to the warehouse containing the property of the plaintiff. The Court held that there was no intervening cause; that the

explosion was the proximate cause of the loss, and as the policy contained the explosion exemption clause the insurer was not liable. It may have been on account of this decision by our highest court that the words "unless fire ensues" were added to the explosion clause in the modern policy.

There is some conflict in the authorities upon the question whether, under a policy phrased like the New York Standard, an explosion occurring during the progress of a fire, should be treated as a mere incident of the fire, the latter being regarded as the efficient cause of the damage, or whether the explosion should be considered proximate in reference to the loss caused thereby, and the insurer be exempt from liability for such damage by reason of the exemption clause of the policy. The overwhelming weight of authority is to the effect that where the fire occurs in the property described in the policy, and an explosion takes place therein during the progress of the fire, such explosion is with respect to such property a mere incident of the preceding fire, the latter being treated as the efficient cause, and the whole loss is within the risk assumed, although the policy in terms excludes liability for loss by explosion.

The undoubted intention of the underwriters when inserting the explosion provision, was not so much for the purpose of exempting themselves from liability for loss by incidental explosions resulting from raging conflagrations occurring in and confined to the buildings in which they originate, where the amount of the explosion damage is practically indeterminate, but rather with the view of eliminating claims for loss by explosions resulting from sparks or small fires, or from causes which are in fact unknown, but which for insurance purposes are attributed to fire, as for instance the Washburn mill loss in Minneapolis in 1877, and the recent Wheeler claim in Buffalo (Washburn vs. Insurance Co., 2 Fed., 304; 29 Fed. Cas., 308, 329, 330; Wheeler vs. Phenix Ins. Co., 41 Ins. Law Journal, 247; 92 N. E. 452). In fact, the intention of the insurers was to exempt themselves from liability for loss by explosions of any kind including those caused by fire, as was correctly stated by the New York Court of Appeals in its dictum in the case of Briggs vs. N. B. & Mercantile Insurance Co., 53 N. Y. 446, and referred to with favor by the same Court in the Hustace case. This would, of course, naturally include within the exception loss caused by concussion.

Let us see, therefore, what value, if any, remains in the explosion exemption clause in the light of the decisions referred to. If the loss were caused by explosion not preceded by a hostile fire, the exception would be unnecessary, for the insurer would not be liable even if the policy did not contain such a provision. It will not do to say that there is room for the exception because explosions are frequently produced by flame, as by a lighted match, a gas jet, burning lamp, fire

in a furnace, and the like; in short, for loss caused by a friendly fire, because the insurer would not be liable for loss by explosion as an incident of such a fire, any more than it would be for any other incidental damage resulting therefrom, even in the absence of the exception. Then again, inasmuch as concussion losses in neighboring property are distinguished from those in the premises where the fire and explosion originate, it can be only on the theory that the concussion of the air due to the explosion is, with respect to such outside property, an independent, intervening cause between the hostile fire and the final effect, and if this be true, then the explosion or concussion, and not the fire, would be the proximate and efficient cause, and the insurer would not be liable even if there were no exception. The fundamental principles underlying friendly fires and proximate and remote cause cannot be affected by the presence or absence of the explosion provision.

There is, however, an intimation in the decision in the Hustace case (supra) which was one involving loss by concussion, that if it were not for the exception there might have been a recovery as for a loss by fire, but this declaration, if such it be, amounts to an admission that the explosion or concussion is not an intervening cause but an inevitable effect and a mere incident of the fire. Can it be possible that the Court intended to imply that the proximity of the cause can shift according to the presence or absence of a stipulation in the policy exempting the company for the explosion loss? And yet, the suggestion that the absence of the explosion exemption clause might have imposed a liability upon the insurer, seems to make for the contention that what, under a given set of circumstances, will be deemed to be the proximate cause, will vary with the introduction or omission of a provision inserted for the purpose of relieving the insurer from liability for a certain species of risk it has concluded not to assume. So much emphasis, however, has been laid upon the exemption provision in the decisions, as a possible controlling factor, that it is perhaps fortunate for the insurers that they were not under the necessity of relying entirely upon the principle of proximate and remote cause as a defense in this class of cases.

In Louisiana a fire broke out about 180 or 200 feet distant from the property of plaintiff, in a building containing a quantity of gunpowder, and in about thirty minutes the gunpowder exploded. The explosion produced such concussion of the air as to cause a damage of about $950.00 to plaintiff's property. The fire continued in the town for forty-eight hours, but did not reach the building in question, it being entirely unharmed except by the concussion. The court which discussed the question at considerable length and apparently based its conclusion upon the supposed intent of the contracting parties, in the course of its remarks said:

"Perhaps after all, it might be safe here, as in other contracts, to inquire whether the loss was within the reasonable intendment of the parties when they made the contract. Did they intend by an insurance against fire to cover losses arising from the concussion of the air produced by an explosion of gunpowder upon the premises of other persons than the insured? We think such an extraordinary result could not have been contemplated by the parties. We do not think insurance companies can be considered responsible for the consequences of the combustion of gunpowder, unless that combustion has happened in the premises insured, or the gunpowder is itself, with other merchandise, covered by the policy." (Caballero vs. Home Ins. Co., 15 La. Ann. 517.)

In Mitchell vs. Potomac Ins. Co. 183 U. S. 42; 22 Sup. Ct. 22; 46 L. Ed. 74, plaintiff's clerk went down into the cellar of the store, which was occupied for the sale of stoves and tinware. He lit a match because it was dark, and the lighted match came in contact with the vapor of gasoline kept in the cellar, and a violent explosion at once followed, causing a collapse of the building. It will be observed that this was a friendly fire, and the Court held that the loss was by explosion, and that the insured could not recover.

Where an explosion was produced by the lighting of a match in a basement filled with illuminating gas, and goods covered by the policy were damaged, but not by burning, and where an inflammable and explosive vapor evolved in the course of the process of extracting oil from shoddy afterward exploded, causing considerable damage, it was held that the insurers were not liable. (Heuer vs. N. W. Nat. Ins. Co. 144 Ills. 393; Stanley vs. Western Ins. Co. 3 L. R. Ex. 71).

In an English case where there was no exception in the policy, it was held that no liability attached where it appeared that the damage which occurred to the premises was occasioned by a concussion of a large quantity of gunpowder at a magazine about half a mile distant. (Everett vs. London Assurance Corp. 115 E. C. 19 C. B. [N. S.] 126).

In a case where the plaintiff's premises adjoined a mill which took fire and shortly after exploded, blowing the plaintiff's house off its foundation and almost ruining it, it was held that insurer was not liable. (Miller vs. London & Lancashire Ins. Co. 41, Ill. App. 395).

In German Fire Co. vs. Roost, decided by the Supreme Court of Ohio (26 Ins. Law Journal, 699) the plaintiff's policy contained the usual explosion clause, and also a special clause insuring against any loss or damage caused by lightning. A powder house situated across the street seventy-one feet away, was struck by lightning; an explosion occurred and plaintiff's house was destroyed by the concussion. It was held that the plaintiff could not recover; and the Court said: "In no case which has come within our observation—and we have examined a great many—has a liability been

found to attach where there was a provision excluding liability for loss by explosion and the loss was caused by fire, or as here, by lightning taking effect in a distant building, and the damage being wrought to the insured property by an explosion produced by the fire or the lightning without either of the latter agencies coming in contact with the insured property."

In Hall & Hawkins vs. National Fire Ins. Co. Tenn. (35 Ins. Law Journal 507) a fire occurred in a hardware store in Knoxville, Tenn., and ignited powder stored therein. A tremendous explosion followed, shaking the whole city and the country for miles around. The resultant concussion damaged plaintiff's stock contained in a building between thirty and forty feet distant, to the extent of several thousand dollars. Held that the insurer was not liable.

The English decisions are in accord with the American decision in respect of these concussion damages, and although they may seem to be in conflict with the oft quoted first Baconian maxim, it is evident that the line must be drawn somewhere, otherwise, as was said by Ryles, J., in an English case (Everett vs. London Assurance Co., 19 C. B. [N. S.] 126) if a ship was in the neighborhood of Etna or Vesuvius and was shaken by an eruption, that would be a damage by fire; or if a gun were fired off, loaded with small shot, among crockery, that would be a damage by fire; or it might be said that if the heat of the sun were too great, that would be a damage by fire.

Where an adjoining building burned, and as the result of fire a party wall fell and carried with it the partition wall and part of the building covered by the insurance, it was held to be a direct loss by fire. (Ermentrout vs. Girard F. & M. Ins. Co. 63 Minn. 305; 65 N. W. 635).

Where a building was destroyed by fire, leaving some of the walls standing, and two days thereafter one of the walls fell, damaging the building covered by the insurance, it was held to be a loss within the policy. (Scottish Court of Sessions 7, Cases in Ct. of Sessions 52, 1 Bennett 259).

Where, for a week after a fire a high wind prevailed and on the seventh day, while a wind amounting to a gale was blowing, a high wall belonging to the burned building fell over on the adjoining building, crushing its roof and doing considerable damage, the Court sustained the finding of the jury that fire was the proximate cause of the loss, and therefore covered by the policy. (Russell vs. German Fire Ins. Co. [Minn.] 1907; 111 N. W. 400).

It is suggested, however, that in cases of this character the right of subrogation might be of value to the insurer against the owner of a building who permits the walls to remain standing for an unreasonable time without taking proper precautions to prevent their falling.

But in a Georgia case it was held that damage to office fixtures resulting from the fall of the building twenty-five days after the fire was not covered, the building having in the meantime been repaired, and heavy rains having fallen which tended to weaken the structure. (Cuesta vs. Royal Ins. Co. 98 Ga. 72, 27 S. E. 172).

In the absence of a stipulation in the policy to the contrary, the insurer would be liable for loss caused by the destruction of property by the order of civil authorities to prevent the spread of a conflagration, and the point is well argued in City Fire Ins. Co. vs. Corlies 20 Wend. (N. Y.) 367. The standard policy, however, contains a special provision covering this contingency, which was no doubt prompted by this and kindred decisions.

The weight of the decisions is in favor of the doctrine that not only loss by removal but also for the expense of removal is a direct loss by fire, whether the building containing the goods be actually on fire or in imminent danger of burning, even without any special provision in the policy. Some doubt, however, has been expressed with respect to the item of expense unless liability therefor is specifically assumed.

In the absence of conditions to the contrary, the insurer under a fire insurance policy is liable for goods stolen during a fire, but the standard policy and others in current use contain an express provision exempting the insurance company from such liability.

It has been suggested that the condition making the policy void if the insured neglects to use all reasonable means to preserve the property at and after a fire, or when the property is endangered by fire in neighboring premises, and the condition exempting the insurer from liability for loss by theft, are inconsistent with each other and that the latter should therefore not be enforceable.

In support of this view the argument is advanced that the effect of these two clauses is to subject the property to a risk against which the insured has no protection; that if the property is negligently lost by theft no clause is necessary; and as property is quite likely to be stolen if removed from a building, the more effectually the insured complies with the conditions of the contract, the more effectually he diminishes his own security. But a Missouri court which held the insurer liable for loss by theft when the policy contained no exemption provision, sustained the validity of the provision in another case, and in a most remarkable decision brushed aside all arguments directed against the alleged inconsistency in the two conditions. (Webb vs. Protection & Aetna Ins. Co.'s 14 Mo. 3; 3 Bennett 509; Newmark vs. L. & L. & G. Ins. Co. 30 Mo. 160; 4 Bennett 464).

Eminent authorities, however, hold that the insurer is not liable under the New York standard policy either for the expense of putting out a fire or of protecting the property at and after a fire, and there are several decisions supporting this view. (Hebner vs. Palatine Ins. Co. 157 Ill. 144—152; Wells vs. Boston Ins. Co., 6 Pick. [Mass.] 182; Ralli vs. Troop, 157 U. S. 386—405).

Except where it is otherwise specifically provided, the insurer will not be liable for consequential damages, such as loss of the use of a store or factory, loss of rents, the incidental loss of trade and consequent loss of prospective profit, these being regarded as too remote, and not supposed to enter into the calculation of the contracting parties. Thus a policy on a bridge does not cover incidental loss of tolls from the adjacent turnpike belonging to plaintiffs. (Farmers Ins. Co. vs. New Holland Turnpike Co. 122 Pa. 37, 15 Atl. 563. Niagara Fire Ins. Co. vs. Heflin, 22 Ky. L. Rep. 1212, 60 S. W. 393. Hayes vs. Ins. Co., 170 Mass. 492, 49 N. E. 754. Niblo vs. Ins. Co., 1 Sandf. [N. Y.] 551.) The standard policy contains a condition expressly disclaiming liability, unless specifically assumed, for loss occasioned "by interruption of business, manufacturing processes or otherwise." Losses of this nature, however, are taken care of by special contracts in the shape of rent, profit and use and occupancy insurance, which class in recent years has assumed quite large proportions.

In the absence of an exemption provision in the policy, it has been held that the insurer is liable for any loss which may accrue to the insured by reason of any ordinance or law regulating the construction or repair of buildings; hence, where a city ordinance will not allow a building that has been damaged by fire to be repaired, the insurer is liable for the entire value of the building, less whatever value remains over the expense of removing it; or, where the building may be repaired, and the ordinance requires changes either of a minor or radical character to be made, the insurer is liable for the additional expense rendered necessary by these changes, unless such liability is expressly disclaimed in the contract.

The proposition is fully discussed in a decision rendered by the Supreme Judicial Court of Massachusetts in the case of Hewins et al. vs. Insurance Company. Under a Massachusetts standard policy which contains no exemption stipulation, the insurer was held liable, but under a New York standard policy which was involved in the same litigation and which contains an exemption provision, liability was limited to the amount needed to restore the building to its original condition. (Hewins vs. London Assurance Corp., 184 Mass., 178; 68 N. E., 62 *Cf.* Brady vs. Insurance Co., 11 Mich., 425; Monteleone vs. Royal Ins. Co., 47 La. Ann. 1563; Hamburg Bremen Ins. Co. vs. Garlington, 66 Tex., 103; Larkin vs. Glens Falls Ins. Co., 80 Minn., 527; Penn. Co. vs. Phil. Contributionship 201 Pa., 497).

The Standard Policy Law of Massachusetts does not, apparently, preclude the insurer from stipulating against such liability, and during the past year a clause has been adopted in Boston expressly disclaiming liability, unless specifically assumed, beyond the actual value of the property described, at the time the loss occurs, or beyond what it would then cost the insured to repair or restore it to the condition in which it was immediately before the loss occurred. And if the insured desires protection against the demolition and increased cost of construction, it can be secured by having a rider covering this feature attached to the policy, in consideration of an additional premium.

The question as to what is a consequential loss is one not entirely free from difficulty. It arises most frequently in connection with breweries, packing houses and cold storage plants. Where the cooling apparatus is located in the same building as the stock, there is no question as to liability for the incidental damage to the latter on account of the interruption of the process of refrigeration. It is where the stock is stored in a building which depends for its refrigeration upon an ice plant located in an adjacent or distant building, that the question of liability for so-called consequential damage presents itself.

Several years ago, in a western city, a large packing house, including the refrigerating plant, was destroyed by fire. About one hundred feet distant from the ice plant, and connected therewith by a cold air conductor, were two storage warehouses, containing about five million pounds of meat. No fire, smoke or water entered the storage buildings, the only damage to the meats therein being that due to a rise in temperature from the shutting off of cold air from the ice plant. The insured asked the consent of the local representatives of the insurance companies to "handle the salvage," and supposing that reference was made to the salvage in the packing house proper, consent was given, whereupon the insured took the entire stock in the two warehouses, shipped some to Boston, some to Buffalo, and some to other places, and presented a claim to the companies for loss and expenses incurred of about $250,000.00. The companies took exception to the amount of the claim, and demanded an appraisement, which resulted in an award of nearly $50,000.00 more than the original claim. The policies simply covered on stock in the warehouses, and contained no reference to consequential loss. This is probably the largest loss of the kind on record.

There never has been any court decision bearing directly on this question, and when the above loss occurred, some insurers, although willing to admit that if the whole plant, including the warehouses and contents had been written under blanket policies for single premiums the entire property might possibly have been regarded as one risk, took the position that inasmuch as the contents of the warehouses were written

under specific policies which had no connection with the general insurance covering the packing house plant, no liability existed for damage to the stock caused by the rise in temperature. If the case could have been tried unaffected by the element of waiver, the court would no doubt have inquired, as in other contracts, whether the loss was within the reasonable intendment of the parties.

If, as has uniformly been held, damage to adjacent property by explosion caused by fire, is regarded as too remote to come within the protection of the policy, it is not clear why the same reasoning does not apply, with equal force, to damage by rise in temperature caused by fire in a neighboring building. If the loss is not regarded as the inevitable physical effect of the fire, in one case, it is not easy to perceive why it should be in the other. And as a matter of principle, it should make no difference whether all the buildings are owned by one man, or whether there are separate ownerships.

In order to guard against any question arising in case of loss on this class of property, policies are now written expressly disclaiming liability for consequential loss, and if the insured desires insurance of this nature, he can secure it by taking out a separate policy covering such risk, or by having an endorsement made on his policy and paying an additional premium therefor.

Let us hear the conclusion of the whole matter. Within the meaning of an ordinary policy of insurance the word "fire" must be construed in its ordinary popular sense, and not be given such technical or restricted meaning as might be applied to it upon scientific analysis. There must be something besides mere combustion; the element of flame or glow must be present. The fire must be without intent on the part of the insured or his responsible agent to injure the property; it must be accidental with respect to the insured. If intentionally kindled for a useful purpose in a place specially designed or provided, the fire does not change its character because the flame extends unusually high, or the heat becomes excessive, or smoke escapes therefrom and causes damage. The fire must be hostile as distinguished from what is universally regarded as friendly, and it must be the proximate and not the remote cause of the loss.

If the hostile fire causes an explosion, the fire is held to be the efficient cause of the whole loss which ensues in the premises where it originates when its effects are produced in direct sequence, though one of the incidents of the sequence may be an explosion, on the theory that it could not have been intended to nullify such predominant cause by the explosion exemption provision.

If as the result of a hostile fire the concussion of the air causes damage to neighboring property, the explosion or concussion, and not the fire, is held to be the proximate cause

of the loss. If a friendly fire causes an explosion, none of the damage resulting can be regarded as a loss by fire.

There are probably some phases of this question which have not been touched upon, and new conditions will no doubt arise to tax the ingenuity of the layman, the lawyer, and the jurist, but a careful study of the text writers, and an analysis of the decisions all tend to confirm and emphasize the correctness of the propositions laid down in the beginning of this address, and to demonstrate that they are fundamentally sound.

Is a Policy Divisible?

A LECTURE

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Is a Policy Divisible?

There is probably no question arising under the fire insurance contract, concerning which there is such diversity of opinion, as that bearing on the subject of the divisibility or indivisibility of the policy.

Prior to the adopton of the New York Standard Policy twenty-five years ago, although there was more or less conflict among the authorities, which in point of number were almost equally divided, the better opinion was that the contract was severable; that is, where it covered several different classes or items of property for separate amounts, either at separate rates or for gross premium, it might be void as to one or more items on account of breach of conditions and valid as to others.

It was no doubt on account of these varying decisions that the framers of the Standard Policy, actuated by the commendable desire of making the meaning so clear that a wayfaring court need not err therein, but by the less commendable desire of making the contract indivisible irrespective of conditions, inserted in line seven (7) the words: "This *entire* policy shall be void . . . " and they evidently thought they had thereby precluded all possibility of its being construed otherwise than as an entire indivisible contract.

It is interesting to note, however, that even under the old forms, which did not contain the word "entire," some courts held firmly to the doctrine of entirety, while others, under the Standard Form, by reason of the insertion of the word "entire," became converts to the principle of entirety, while still others continued to decide in favor of divisibility despite the phraseology "This entire policy shall be void."

The question in one form or another has been before the courts many times, and the decisions which have been rendered by the highest tribunals of more than three-fourths of the states may, in general, be classified as follows; to wit:

First: That the policy is divisible, even though the risk may be entire.

Second: That the policy is entire, even though the risk may be divisible.

Third: That where the risk is divisible, the policy is divisible.

Although the decisions in some of the states have not been uniformly consistent, the following may be taken as a fairly accurate classification of the attitude of the courts on the question:

Those in favor of divisibility are New York, Kentucky, Kansas, Nebraska, Illinois, Missouri, Alabama, Colorado, West Virginia, Mississippi, Oklahoma, Delaware, Montana, North Dakota and South Dakota. In the last three states the question is regulated by statute under certain conditions.

Those in favor of entirety are Georgia, Massachusetts, Maine, Pennsylvania, Ohio, Tennessee, Louisiana, Connecticut, Maryland, Minnesota, New Jersey, North Carolina, Rhode Island, Arkansas, District of Columbia and United States Circuit Court of Appeals.

Those in favor of entirety, only when the risk is entire, are Washington, Michigan, Iowa, Indiana and Virginia.

New Hampshire and Vermont may be placed in the doubtful column. The earlier Texas cases favored divisibility, the later ones favor conditional entirety.

In the above classification, those states favoring divisibility have decided unqualifiedly in favor of that doctrine under all conditions except fraud. A few of those favoring entirety have declared unqualifiedly in favor of that principle. In many of the cases decided, however, the risks were entire and some of the courts were, doubtless, influenced by that fact in rendering their decisions in favor of entirety. It is highly probable that if called upon to decide cases where the risks are divisible, some of those states, which in the above classification have been placed in the "entirety" column, will be transferred to the list of those favoring conditional divisibility.

Many of the courts which have held the policy to be entire, have based their decisions upon the rule appertaining to contracts generally, that entirety of consideration renders the contract entire, and this has been regarded by them as the controlling factor, irrespective of the phrase "This entire policy shall be void," . . . .

Others, on the contrary, do not regard this as controlling, but argue that premiums are not fixed at an arbitrary lump sum, but are ascertained by applying definitely fixed rates to the amounts insured, and adding together the amount required for each separate risk; hence, to say that the premium or consideration is indivisible is a legal fiction, for it is just as easy to divide as it was originally to compute it. The premium might well be stated separately, but for convenience, the amount thereof is stated in a gross sum.

In these days as many as five hundred separately valued items are sometimes included under the cover of a single policy, and hundreds of policies are written every day covering specifically no less than one hundred different items. Yet, if any one of these, no matter how small, or how far removed from the other items described, proves to be a building on ground not owned by the insured in fee simple, or be personal property, and be or become encumbered by a chattel mortgage, without consent thereto being endorsed on the policy, the entire contract, according to the view of the strict constructionists, is void, and the loss on the items not directly involved in the breach, is uncollectible.

Some courts have apparently felt that it is unreasonable to suppose that the Legislatures which adopted the Standard Policy, or the parties themselves, should intend to avoid the entire contract for some trifling mistake relating perhaps to only one of many items, possibly geographically independent of each other, and have, therefore, practically ignored the word "entire" in their endeavor to give effect to the main purpose of the policy. Others, however, have adhered to a literal construction and have virtually ruled that the words "this entire policy" mean one thing only and cannot possibly mean anything else.

If an insurance company should be small enough to deny all liability under a policy containing fifty different items, simply because a condition had been violated in respect of one item differently located, it would be interesting to observe whether those courts which seem to be committed to the doctrine of unqualified entirety, would be great enough to stand by their principles and grant a forfeiture as to all items; and, if not, what avenue of escape they would find.

It is true that overinsurance on stock will affect the building containing it as well as the stock itself; that the undesirability of a risk on a building on leased ground, with a short time to run and without the privilege of renewal, will apply with equal force to the stock and fixtures therein, and that a chattel mortgage on stock or fixtures which increases the risk thereon, also increases the risk on the building in which they are contained. And these considerations probably had no little to do with the insertion of the word "entire" in the Standard Policy.

These are undoubtedly strong points in favor of conditional entirety; that is, if the breach as to one item or class increases the risk on the rest, the policy should be altogether avoided. But they do not constitute any argument whatever in favor of unconditional entirety of contract and no ethical argument can be advanced in favor of that doctrine. The advocates of the extreme view of entirety under all conditions, have nothing to stand upon except "entirety of consideration," and the phrase "this entire policy shall be void" . . . But these considerations appear to have been

quite sufficient, according to the view of those courts which have adhered to that doctrine.

There are a number of points that may be urged against both the principle of unqualified entirety and conditional entirety and in favor of absolute divisibility.

In the first place, the insured can, except in rare instances, for the asking, secure a policy on each item, such as building, machinery and stock, for the same aggregate premium that he would have to pay for a single policy embracing all the items with separate amounts on each. The minds of the insurer and the insured meet upon the rate or rates, and the amounts to apply to each item, and all the insurances contracted for are written on one piece of paper familiarly known as a policy, and is accepted by the insured. If he or his broker requests separate policies for each separately valued item, he can get them, but because he does not subject the underwriter to this trouble and as a matter of convenience principally to the latter, he accepts one document including all the items, it is submitted that this mere circumstance should not place the insured in any less advantageous position than he would have occupied if he had asked for separate policies.

Then again, what has been and what is the daily practice of insurance companies with respect to this question of divisibility? The contribution clause providing for the apportionment of loss among the various insurance companies interested, has been in general use for nearly a century, and has always read substantially the same as in the New York Standard Policy:

> "This Company shall not be liable under this policy for a greater proportion of any loss on the described property," . . . "than the amount hereby insured shall bear to the whole insurance" . . "covering such property." (Lines 96-98.)

It says "this *policy*" and "*amount* hereby insured." It does not say "This company shall not be liable for a greater proportion of any loss on the property described in *each item* of this policy, than the amount hereby insured on *each item* shall bear to the whole insurance on *each item* respectively;" yet, no court decision involving the question of apportionment has ever been rendered, and no loss among the millions that have occurred since the contribution clause came into use, has been apportioned between companies, except on the basis of each separately valued item being treated as a separate policy. Thus, in construing the contribution clause, the policy has been and is universally recognized by the courts and the entire insurance fraternity as divisible.

This is also true in respect of the cancellation clause—"This policy shall be cancelled at any time" . . .

Thousands of policies are cancelled every year, not only as to one or more separate items, but policies covering one

item only are cancelled in part and a ratable portion of the premium is returned to the insured. Thus for many years we have had another recognition of the principle of divisibility on the part of insurance companies in their daily practice, and this recognition has not stopped at items but has even been extended to parts of items.

It is no doubt true, as indicated by text writers, that the request or notice of cancellation must contemplate an absolute termination of the entire contract, not a reduction of its amount, inasmuch as the terms of the cancellation clause offer no option to either party to cancel in part. If so, legal cancellation in part cannot be effected except by mutual agreement.

It goes without saying that no insurance company desiring to relieve itself of liability would care to take any chances as to the legality of the cancellation by having the notice relate to one or more items of the policy only, but would have it embrace the entire contract.

The cancellation clause in respect of the right to cancel, is, of course, alike applicable to the insurer and the insured; but if the insured—who is less conservative than the insurance companies—should desire to cancel one or more items of a general form, or should insist upon canceling only the stock item of a policy covering specifically on building and stock, it would not be at all surprising if, in those states which have declared unqualifiedly that the policy is divisible, the court would permit partial cancellation, notwithstanding the fact that the cancellation clause refers to "this policy," and also provides for surrender upon payment of the unearned premium. In fact, it is difficult to perceive why the words "this policy," should be given any different interpretation when construing the cancellation clause than it is when interpreting the contribution clause.

If the theory as to the indivisibility of the premium be incorrect, and if the principle that two or more separately valued insurances, evidenced by one piece of paper, are severable, be sound, the fundamental principle is not affected by the word "entire," as used in the clause declaring the "entire policy" void, and it applies only to that insurance or to that portion of the policy as to which the breach has occurred.

The following is a brief summary showing the conflicting views of different tribunals on various phases of the question:

ALABAMA.—A mortgage on pool tables does not avoid the policy as to other contents of the building. Violation of iron-safe clause voids policy as to stock, but not as to building.

CONNECTICUT.—The risk on contents might be increased by sale of the building; *held,* that breach as to building avoids as to contents also.

DISTRICT OF COLUMBIA.—A chattel mortgage on part of household effects avoids the entire policy: Decision governed by the word "entire."

COLORADO.—Notwithstanding the word "entire," *held*, that policy is not avoided as to the whole by breach affecting only a part of the property.

DELAWARE.—The statute as to valuation of building *held* to be a quasi penal statute, and violation thereof by overinsurance voids policy as to building only.

U. S. CIRCUIT COURT OF APPEALS.—A chattel mortgage on personal property avoids policy both as to building and contents.

GEORGIA.—The premium being entire, a breach of condition as to stock avoids policy as to building also.

ILLINOIS.—Vacancy of one house does not avoid the policy as to another, unless the risk on latter is affected. The general trend of Illinois decisions favors divisibility.

INDIANA.—A policy covering on house and barn, *held* divisible. Misrepresentation regarding one building will not affect recovery on another building when insured specifically. In general, the Indiana rule is that if the various classes of property are so situated in respect to each other as to constitute one risk, the contract is entire, otherwise not.

IOWA.—Vacancy as to house does not avoid as to barn. Chattel mortgage on cattle does not avoid as to house and furniture. Breach as to building avoids as to machinery therein. The Iowa rule apparently is that the policy is divisible only when the risk is divisible.

KANSAS.—Notwithstanding the word "entire," the insurance on contents is undisturbed by a prohibited mortgage on real estate. Kansas holds that the premium is easily apportionable.

KENTUCKY.—Fraud as to one item avoids policy as to all. Kentucky holds that when different items of property are separately valued, there is, in effect, a separate insurance on each particular class or item of property so valued; and it logically follows that what might affect one policy of insurance, would not necessarily affect the other.

LOUISIANA.—Breach as to building avoids policy as to contents also. When personal property is contained in two different buildings; *held*, the policy is entire.

MAINE.—A policy covering on non-hazardous merchandise is avoided as to entire item by presence of hazardous articles, not simply as to the hazardous articles—governed by the fact that premium is entire. The general trend of Maine decisions is in favor of entirety.

MARYLAND.—Prohibited vacancy as to building also avoids policy as to contents. Other insurance without notice on one item avoids entire contract.

MICHIGAN.—*Held,* a policy covering real and personal property can be regarded as divisible only when the risk on each is different.

MINNESOTA.—A building on leased ground without notice, avoids policy as to personalty also. Increase of moral hazard as to one item increases it as to both. Fraud as to one item avoids as to all. In one case Minnesota adopted the Texas and Arkansas rule, to which reference will be made later. The policy covered a mining plant consisting of several buildings, one of which was vacant. The court *held* that, as the consideration was entire, the policy must be regarded as entire, so that a vacancy of one of the buildings constituting the plant, did not affect the validity of the policy as to either building.

MISSISSIPPI.—Violation of iron-safe clauses does not invalidate policy as to furniture and fixtures.

MISSOURI.—Misrepresentation as to one item does not affect other separately valued items. The word "entire" applies only to the portion of the policy affected, and does not affect the character of the policy as a divisible contract.

MONTANA.—Insurance on building *held* undisturbed by chattel mortgage on contents. The premium might easily be stated separately, and gross sum is stated for convenience.

NEBRASKA.—Insurance on contents is not disturbed by alienation of real estate. The trend of Nebraska decisions favors divisibility.

NEW JERSEY.—Breach of condition as to building avoids as to contents also.

NEW HAMPSHIRE.—Alienation of one parcel avoids policy as to all, unless the court can rule that there has been no increase in risk.

NEW YORK.—Under an old form of policy reading, "if the property insured *or any part thereof be encumbered,*" it was *held* to be indivisible; but the New York decisions generally, and particularly those under the Standard Policy, which are numerous, strongly favor divisibility.

The fact that the Standard Policy makes breaches of warranty apply to property generally, and not to "any part thereof," as in some of the older issues, has apparently opened the way to the Court of Appeals to adhere to the principle of divisibility, despite the words "this entire policy shall be void."

NORTH CAROLINA.—Violation of iron-safe warranty which avoids policy as to stock, avoids as to building also. Breach as to building also avoids as to contents.

NORTH AND SOUTH DAKOTA.—Statutes in both states provide that change in interest in one or more of several distinct things separately covered, does not avoid policy as to others.

OKLAHOMA.—If different classes of property are separately valued, the contract is severable, notwithstanding the word "entire."

OHIO.—This state switched from divisibility to entirety by reason of the word "entire" in the Standard Policy, and ruled that if one item of contents was not owned absolutely by the insured, the entire policy was void.

PENNSYLVANIA.—Breach as to ownership of machinery avoids policy as to building and stock. Gunpowder in one of three buildings, which endangers all, renders policy void as to all: Governed by entirety of premium.

RHODE ISLAND.—Breach as to ownership of part of contents avoids policy as to all.

TENNESSEE.—This state, like Ohio, shifted its position from that of divisibility to entirety, by reason of the word "entire," and held that fraud as to one item avoided policy as to all.

VERMONT.—Where the insurance company had a lien on real estate for entire premium, the court held that a prohibited mortgage on building also avoided insurance as to contents.

WASHINGTON.—Breach of warranty as to piano avoids entire policy on contents, though separately valued. If entire risk is affected by the breach, separate valuations are of no effect to prevent forfeiture of entire policy.

In Washington, the policy would probably be held to be divisible, provided breach does not effect the entire risk.

WEST VIRGINIA.—This state comes out boldly and declares that the general rule as to whether a contract is entire or divisible, should not be applied to insurance policies, and prefers to be guided by considerations of equity and reasonableness of construction. It has decided in favor of divisibility.

VIRGINIA.—If the risk is severable, the policy is severable.

The Supreme Court of Arkansas and the Court of Civil Appeals of Texas have turned the tables on the underwriters quite ingeniously if not logically, by holding that the breach of condition must affect the entire subject matter, otherwise no forfeiture at all will result.

In McQueeny vs. Phoenix Ins. Co., 52 Ark. 257, it was *held* that where the policy covered two dwellings situated thirty feet apart, separately valued, vacancy of one did not invalidate the policy as to either, and virtually ruled that in order to invalidate the policy, both dwellings must be vacant.

In case of Bills vs. Hibernia Ins. Co., 87 Tex. 547, the Texas Court of Civil Appeals decided that where a policy contained the stipulation—

> "This entire policy shall be void if the subject of insurance be a building on ground not owned by the insured in fee simple"—

and the policy covered separate amounts on building and machinery, the fact that the building was on leased ground did not invalidate the insurance on either item because "the subject of insurance" consisted of the house *and* machinery.

The same court also held to the same doctrine in the recent case of Spring Garden Ins. Co. vs. Brown. Vol. 41 Ins. L. J., p. 735. The policy contained the clause.

> "This entire policy, unless otherwise provided by agreement indorsed hereon, or added hereto, shall be void, if the subject of insurance be personal property and be or become encumbered by a chattel mortgage."

The policy covered a separate amount on stock and a separate amount on fixtures. The stock was encumbered by a chattel mortgage, and the Court, following the decision in the Bills case, *held* that, as the "subject of insurance" consisted of stock *and* fixtures and the mortgage applied to stock only, the policy being entire, it was not invalidated as to either item.

Conversely, where the policy contained a provision that the policy should be void if the subject of insurance or "any part thereof" was incumbered, the Texas court held that the entire policy was void, although only a portion of the property was incumbered. Curlee vs. Texas Home Fire Ins. Co., 31 Tex. Civ. App. 471.

The construction placed upon the contract in the Bills case and the Brown case, is not only a strained one, but also at variance with the principles established at common law. The court seems to have been influenced by the fact that in the Curlee case the policy contained the words "or any part thereof," whereas, in the Bills and Brown cases these words were omitted.

New York seems to have taken the omission of the words "or any part thereof" as an excuse for construing the policy as divisible. Texas, on the other hand, has taken the omission as a basis for construing it as entire in the cases referred to.

The word "entire" does not appear in the Massachusetts Standard Policy; yet, the Massachusetts court holds that if the premium be an entire amount, the contract is not divisible, and forfeiture as to one item defeats the entire claim. But that staunch adherent to the principle of entirety has held that if a portion of the property is sold without the insurer's consent, that portion is simply removed from the cover of the policy. Bullman vs. N. B. & Mercantile Ins. Co., 159 Mass. 118; Clark vs. New England M. F. Ins. Co., 6 Cush. (Mass.) 342.

The supreme Court of Wisconsin, in the case of Schumitsch vs. American Ins. Co., 48 Wis. 26, laid down the following interesting rule; to wit: Where a policy covers sev-

eral classes of personal property, and any property of that description is subsequently mortgaged and placed in the building so that the risk will attach to it under the general language used, and the insured claims that such mortgaged property is covered by the policy, the mortgage should be deemed a breach of the conditions of the policy. If, however, the insured should place subsequently mortgaged property in the building, not claiming that it was covered by the policy, and other personal property in the building which was covered by the policy should be destroyed, the insurance on the unincumbered property would not be affected by the fact that the mortgaged property was in the building at the same time and destroyed with it.

In line with the foregoing, it has been suggested that if several classes of personal property be covered under the general language of the policy for one amount, and one or more classes or articles be incumbered by a chattel mortgage at the time the policy is issued, the insured should be given the option of eliminating such mortgaged articles from the cover, in order to avoid forfeiture as to the others.

For instance, if a printing press encumbered by a chattel mortgage be included in general terms in the machinery item of a policy covering a printing establishment should not the insured, in order to prevent a forfeiture as to the entire item, be permitted to say that it was not intended that the policy should cover that particular press? This appeals quite strongly to our ideas of equity, as does also the elimination of subsequently acquired mortgaged property, as distinguished from the placing of an incumbrance upon a portion of the property after the issue of the policy, but the New York courts have *held* that if there be not only a gross premium, but also no separate apportionment of amounts of insurance, a breach affecting part of the subject matter avoids the whole contract; thus, a chattel mortgage on a part of the furniture and fixtures would forfeit the insurance as to the whole property of that class, whether the incumbrance existed at the time the policy was issued, or attached after issue. Fitzgerald vs. Atlanta Home Ins. Co., 175 N. Y. 494; Vucci vs. N. Brit. & Merc. Ins. Co., 88 N. Y. Supp. 986.

If any significance whatever is to be placed upon the word "entire," it would surely seem that the principle of divisibility had reached its limit when it permits the division of the policy into its separately valued items.

The decisions in the United States, England and Canada appear to be uniformly in favor of the primary rule that any fraud on the part of the insured, though relating to a single item of the subject matter, avoids the entire policy. The penalty as to misrepresentation, not amounting to fraud, however, is not so severe, and it affects only the item concerning which it is made. A misstatement that the insured has no reason to suspect incendiarism, quite properly voids the entire

contract. Phillips holds to the doctrine that if a fact suppressed relates only to a part of the goods or subjects of insurance, but yet enhances the risk on the whole, it is a concealment in respect to the whole, and holds conversely, applying the same criterion, that if the suppressed fact does not enhance the risk on the remainder of the property or on the other subjects of insurance, it will remain in force upon these. Vol. 1, p. 381.

A blanket policy is generally regarded as more advantageous to the insured than specific policies, but a study of this subject would lead one to conclude that under certain conditions in many states he would be better off with specific policies.

Cooley, in his concluding remarks on this interesting subject, uses the following language:

> "Though in some jurisdictions the fact that the consideration for the policy is entire, has led the courts to declare the contract entire, an examination of the cases justifies the statement that the rule established by the weight of authority is that, if the policy covers separate classes or items of property, separately valued and insured for separate amounts, the contract is divisible, and a breach of warranty or condition which affects only one of the classes or items covered will not avoid the insurance on the other classes or items. The fact that the policy contains a declaration that the entire policy shall be void on a breach of condition, does not change the rule. Reason and justice require, however, that the rule should be modified when various classes of property are so situated in respect to each other that the risk is substantially the same on all, and in such cases a breach of condition or warranty which increases the risk on one class or item of the property insured, should forfeit the whole insurance."

Although admitting the seeming reasonableness of the suggested modification, yet, in reaching my own conclusions in favor of unqualified divisibility as to items, I have been largely influenced by the interpretation which the insurance companies themselves, for many years, have placed upon other portions of the contract in their everyday practice, and also by the belief that the insured should not suffer by the mere fact that he failed to insist upon that which would have been freely granted upon request, without additional cost.

It is easy to understand how a court can declare the policy to be entire under any and all conditions, and I realize that it is somewhat difficult to escape from a strict literal interpretation of the contract; but to hold that a policy containing several separately valued items, under one state of facts, is entire, and under another state of facts, is divisible, is certainly illogical. There are good reasons, as has been pointed out, for holding that each separately valued item is,

in effect, a separate and distinct contract, and if this construction is possible or permissible, each item is unqualifiedly distinct, and should be so construed, irrespective of conditions, and treated precisely the same as if a separate policy had been actually issued on each item. A decision which holds that the words "this entire policy" mean a certain thing in one case, and something entirely different in another, is inconsistent and arbitrary. I can perceive no logical middle ground between absolute entirety and absolute divisibility of the contract, and as, for the reasons stated, I feel warranted in rejecting the former, notwithstanding its apparent legal soundness, I am, of course, under the necessity of accepting the latter, which I do with very good grace, because I believe it to be ethically sound.

FORMS

—From the Company's Standpoint

AN ADDRESS

DELIVERED BEFORE

The Insurance Society of New York

February 20th, 1912

BY

W. N. BAMENT
General Adjuster

THE HOME INSURANCE COMPANY
NEW YORK

Forms—From the Company's Standpoint

By W. N. Bament

The subject of insurance forms is such an exceedingly broad one, that it will be impossible in an address such as this to do more than touch upon it in a general way, and direct attention to some of the more important forms, which, although in general use, may possess features which are not fully understood.

The best form, whether viewed from the standpoint of the insurance company or the insured, is a fair form, one which expresses in clear, unambiguous language the mutual intention of the parties, and affords no cause for surprise on the part of either, after a loss has occurred. But the preparation of such a form is not always an easy task, and it is right at this point that the ability of the broker and the underwriter come into play.

A distinguished Englishman declared that the English Constitution was the greatest production that had ever been conceived by the brain of man, but it was subjected to the most scathing criticism and violent assaults by Bentham, the great subversive critic of English law. Twenty-five years ago the New York Standard Policy was prepared by the best legal and lay talent in the insurance world, and the greatest care was taken to present not only a reasonable and fair form of contract between the insurer and the insured, but one which could be easily read and understood.

While no such extravagant claims have been made for the Standard Policy as were made for the "Matchless Constitution," it has for a quarter of a century stood the test of criticism fully as well, if not better than its most ardent friends could have reasonably expected, yet some of its more important provisions have frequently been before the courts for construction, and the various tribunals have differed radically in their decisions.

A perfect constitution and a perfect policy may therefore be safely placed in the list of things unattainable, but if there is any one who can make a nearer approach to perfection in the art of constructing a written form which will result in a

maximum of loss collection with a minimum of co-insurance or other resistance than a present day broker, he has not yet been discovered.

The ornate policies in use thirty years ago, with no uniformity in conditions, with their classification of hazards which no one could understand and their fine print which few could read, have given way to plainly printed uniform Standard Policies with materially simplified conditions. But the written portion of the insurance contract owing to our commercial and industrial growth, instead of becoming more simple, has taken exactly the opposite direction, and we now have covering under a single policy or set of policies, the entire property of a coal and mining company, the breweries, public service or traction lines of a whole city and the fixed property, rolling stock and common carrier liability of an entire railroad system involving millions of dollars and containing items numbering into the thousands. This forcibly illustrates the evolution of the policy form since the issue of the first fire insurance contract by an American company one hundred and sixty years ago, in favor of a gentleman bearing the familiar name of John Smith, covering

"500 £ on his dwelling house on the east side of King Street, between Mulberry and Sassafras, 30 feet front, 40 feet deep, brick, 9-inch party walls, three stories in height, plastered partitions, open newel bracket stairs, pent houses with board ceilings, garrets finished, three stories, painted brick kitchen, two stories in height, 15 feet 9 inches front, 19 feet 6 inches deep, dresser, shelves, wainscot closet fronts, shingling 1-5 worn."

It will be observed that in the matter of verbiage this primitive form rivals some of our present day household furniture forms and all will agree that this particular dwelling might have been covered just as effectually and identified quite as easily without such an elaborate description.

Any one who has an insurable interest in property should be permitted to have any form of contract that he is willing to pay for, provided it is not contrary to law or against public policy, and judging from a contract of insurance issued by a certain office not long ago the insuring public apparently has no difficulty in securing any kind of a policy it may desire at any price it may be willing to pay. The contract in question was one for £20,000, covering stock against loss from any cause, except theft on the part of employes, anywhere in the Western Hemisphere, on land or water, without any conditions, restrictions or limitations whatsoever, written at less than one-half the Exchange rate in the insured's place of business. An insurance agent upon being asked whether he thought it was good, said that if the company was anywhere near as good as the form, it was all that could be desired, but vouchsafed the opinion that it looked altogether too good to be good.

In these days we frequently find concentrated within the walls of a single structure one set of fire insurance policies covering on building, another on leasehold interest, another on rents or rental value—and in addition to this, policies for various tenants covering stock, fixtures, improvements, profits and use and occupancy, subject to the 100% average or co-insurance clause, to say nothing of steam boiler, casualty and liability insurance, thereby entirely eliminating the element of personal risk on the part of the owners, and producing a situation which will account in some measure for the 17,000 annual fire alarms and $15,000,000 fire loss in New York City; $230,000,000 annual fire loss in the country at large, and for the constantly increasing percentage of cases where there are two or more fires in the same building and two or more claims from the same claimant.

The most common and perhaps least understood phrase found in policies of fire insurance is what is known as the "Commission Clause," which reads "his own or held by him in trust or on commission or sold but not delivered" or "removed." This clause in one form or another has been in use for many years, and it was originally the impression of underwriters that owing to the personal nature of the insurance contract a policy thus worded would simply cover the property of the insured and his interest in the property of others, such as advances and storage charges, but the courts have disabused their minds of any such narrow interpretation and have placed such a liberal construction upon the words "held in trust" that they may be justly regarded as among the broadest in the insurance language and scarcely less comprehensive than the familiar term "for account of whom it may concern"; in fact, the principles controlling one phrase are similar to those governing the other.

It has been held that whether a merchant or bailee has assumed responsibility, or agreed to keep the property covered or whether he is legally liable or not, if his policies contain the words "held in trust," the owner may, after a fire, by merely ratifying the insurance of the bailee, appropriate that for which he paid nothing whatever and may file proofs and bring suit in his own name against the bailee's insurers. Nor is this all, for in some jurisdictions, if the bailee fails to include the loss on property of the bailor in his claim against his insurers, or if he does include it and the amount of insurance collectible is less than the total loss, the bailee may not first reimburse himself for the loss on his own goods and hold the balance in trust for the owners, but must prorate the amount actually collected with those owners who may have adopted the insurance, although, if he has a lien on any of the goods for charges or advances, this may be deducted from the proportion of insurance money due such owners.

The phrase "for account of whom it may concern" was formerly confined almost entirely to marine insurance, but in recent years there has been an increasing tendency to introduce it into policies of fire insurance.

All authorities are agreed that the interests protected by a policy containing these words must have been within the contemplation of him who took out the policy at the time it was issued. It is not necessary that he should have intended it for the benefit of some then known and particular individuals, but it would include such classes of persons as were intended to be included and who these were may be shown by parol. The owners or others intended to be covered may ratify the insurance after a loss and take the benefit of it, though ignorant of its existence at the time of the issuance of the policy, just the same as under the term "held in trust."

The words "for account of whom it may concern" are not limited in their protection to those persons who were concerned at the time the insurance was taken out, but will protect those having an insurable interest and who are concerned at the time when the loss occurs. They will cover the interest of a subsequent purchaser of a part or the whole of the property and supersede the alienation clause of the policy (U. S. S. C.), Hagan and Martin vs. Scottish Union and National Ins. Co., 32 Ins. Law Journal, p. 47; 186 U. S. 423).

A contract of insurance written in the name of "John Doe & Co. for account of whom it may concern" should contain a clause reading "Loss, if any, to be adjusted with and payable to John Doe & Co.," not "loss, if any, payable to them" or "loss, if any, payable to the assured," as forms sometimes read.

Policies are frequently written in the name of a bailee covering "On merchandise, his own and on the property of others for which he is responsible," or "for which he may be liable"—and it has been held that the effect of these words is to limit the liability of the insurer to the loss on the assured's own goods and to his legal liability for loss on goods belonging to others, but the words "for which they are or may be liable" have been passed upon by the Supreme Court of Illinois, and they have been given an entirely different interpretation. That tribunal in the case of The Home Insurance Company vs. Peoria & Pekin Union Railway Co. (28 Insurance Law Journal, p. 289; 178 Ills. 64) decided that the words quoted were merely descriptive of the cars to be insured; that the word "liable" as used in the policy did not signify a perfected or fixed legal liability, but rather a condition out of which a legal liability might arise.

As illustrative of its position the court said that an assignor of a negotiable note may, with no incorrectness of speech, be said to be liable upon his assignment, but his

obligation is not an absolute fixed legal liability but is contingent upon the financial condition of the maker; and accordingly held that the insurance company was liable for loss on all the cars in the possession of the railroad company, notwithstanding the fact that the latter was not legally liable to the owners.

In view of the exceedingly broad construction which the courts have placed upon the time honored and familiar phrases to which reference has been made, it is important for the party insured, whether it be a railroad or other transportation company, a warehouseman, a laundryman, a tailor, a commission merchant or other bailee, to determine before the fire whether he desires the insurance to be so broad in its cover as to embrace not only his own property and interest, but also the property of everybody else which may happen to be in his custody; if so, he should be careful to insure for a sufficiently large amount to meet all possible co-insurance conditions, and if he wishes to make sure of being fully reimbursed for his own loss, his only safe course is to insure for the full value of all the property in his possession.

At this point the inquiry which naturally presents itself is, how should a policy be written if a merchant, warehouseman or other bailee desires to protect his own interest but not the interest of any one else? The following form is suggested: "On merchandise his own, and on his interest in and on his legal liability for property held by him in trust or on commission or on joint account with others, or sold but not removed, or on storage or for repairs, while contained, etc." This will, it is believed, limit the operation of co-insurance conditions and at the same time prevent the owners from adopting, appropriating or helping themselves to the bailee's insurance, for which they pay nothing and to which they are not equitably entitled.

Many of the household furniture forms now in use, in addition to embracing almost every conceivable kind of personal property except that specifically prohibited by the policy conditions, are also made to cover similar property belonging to any member of the family or household, visitors, guests and servants.

This form would seem to indicate considerable ingenuity on the part of the broker, broad liberality on the part of the insurance company and commendable generosity on the part of the insured, and the latter would probably feel more than compensated by being able to reimburse his guest for any fire damage he might sustain while enjoying his hospitality, but the amount of insurance carried under such a form should anticipate the possibility of his having a number of guests at one time and a corresponding increase in the value at risk.

It must be borne in mind that in localities where co-insurance conditions prevail the value of property belonging

to all members of the household, guests and servants will be taken into account for co-insurance purposes in event of loss, and as guests frequently have with them wearing apparel and jewelry of considerable value, a situation might easily arise which would result in quite a large part of the loss being uncollectible.

But aside from the element of co-insurance, which is not generally applicable to household furniture risks, the fact remains that under such a form the members of the household, visitors, guests and servants are insured quite as effectually as the party specifically named as the "insured" in the policy, and by merely adopting the insurance which has been generously provided, they will have just as much right to the proceeds, to the extent of their interest, as the nominal insured, for a policy so written is controlled by the same principles as those governing property held in trust or for account of whom it may concern.

If, therefore, the insured does not desire to carry insurance for an amount sufficiently large to meet these possible contingencies, he should content himself with a less ambitious form of policy, otherwise he may under certain conditions find himself the victim of his own generosity.

In the absence of co-insurance conditions, this broad, all-inclusive form need not give the average householder any special concern for it is highly improbable that a guest at a private residence would presume, uninvited, to avail himself of his host's insurance, although servants and members of a household who are not members of the family might not be so considerate.

It is, however, an exceedingly dangerous form for use in policies covering the contents of *quasi* public institutions, hotels and boarding houses, for it is hardly conceivable that the managers or proprietors would desire to carry and pay premium on insurance sufficient to cover the uncertain and constantly changing value of the property of their guests, especially when they are under no obligation to do so.

The question is frequently asked whether goods in bond should be insured for the value with or without the inclusion of customs duties or internal revenue tax; also whether the policy form should affirmatively include or exclude the duty or tax or make no mention of it whatever.

According to the internal revenue laws (Sections 3221 and 3223), when any distilled spirits in bond are destroyed by accidental fire or other casualty, without any fraud, collusion or negligence of the owner thereof, no tax shall be collected on such spirits so destroyed, or, if collected, it shall be refunded upon the production of satisfactory proof that the spirits were destroyed as specified in the statute. But when the owners may be indemnified against such tax by a valid claim of insurance, for a sum greater than the actual value of the distilled spirits, before and without the tax be-

ing paid, the tax shall not be remitted to the extent of such insurance. In short, the insurance would be regarded as covering the tax to that extent, and the insurance companies would have no subrogation rights. As virtually all losses on spirits in bond occur without negligence on the part of the owner, and as the statute makes the refund or cancellation of the bond mandatory, there would seem to be no necessity whatever for insuring the tax, and the usual and better practice is to affirmatively exclude it in the policy forms.

As respects duties on imports, the situation is somewhat different. According to Section 2984 of the United States Revenue Statutes, the Secretary of the Treasury is "authorized," upon production of satisfactory proof of the actual injury or destruction, in whole or in part, of any merchandise while in bond, by accidental fire or other casualty, to abate or refund, as the case may be, the amount of import duties paid or accruing thereupon; and, likewise to cancel any warehouse bond or bonds in whole or in part, as the case may be.

Although there is no court decision definitely passing upon the question as to whether the above provision is mandatory or whether the matter is left by the statute entirely within the discretion of the Secretary of the Treasury, it has for years been the practice of the Treasury Department to treat it as if it were mandatory, and it is practically certain that the owner of goods in a bonded warehouse would not lose anything on account of duties in event of destruction of the property by fire.

Some very good authorities entertain the opinion that it is not advisable to affirmatively exclude duties from the cover of the policies, and in the absence of special mention of the duties in the form, the imported value, without duties, will be the basis of settlement for loss and co-insurance purposes.

All the decisions prior to the enactment of Section 2984, providing for the refund or abatement, were to the effect that as the insured was absolutely liable to pay the duties, even though the goods were destroyed, his only relief was to look to his insurers, but there does not appear to have been any decision since the enactment of said section as to its effect upon the liability of the insurer.

On the other hand, some good authorities entertain the opinion that if the insurance is sufficient in amount and the duties are not expressly excluded, it would be held to cover them, because they become an obligation immediately upon importation, and the owner is liable for them until he obtains their remission. In this view of the matter, the fact that it is more or less easy to get the duties remitted is immaterial, and it is believed by those who entertain the above opinion, that the courts would not allow the insurance company to compel the insured to reduce his claim against it by enforcing his rights against the United States Government.

This might possibly be true if the duties were already paid at the time of the fire or paid subsequently in order to secure the release of the property for salvage purposes, but in this event the insurance company would be subrogated to the rights of the insured against the Government. If, however, the property is totally destroyed and the duties remain unpaid, it is difficult to perceive how the insured can collect anything beyond the invoice value, for until he actually pays the duties, he sustains no loss thereon, even temporarily, and if they are remitted, he never will sustain any loss thereon.

The mere fact, however, that there has been no final court decision, and that there are differences of opinion on the subject, emphasizes the advisability of having it definitely stated in the policy form whether the duty is to be considered a part of the value insured or not, and it is also desirable to have it determined before the fire occurs by whom the duty and warehouse charges shall be paid, in event of its being necessary to remove the stock from the bonded warehouse to protect it from further damage, or for salvage or other purposes.

The following form, which is used by some companies, would seem to meet the necessities of the situation when it is desired to exclude the duty as a part of the value:

It is understood and agreed that the Custom House duties payable to the United States Government on property covered by this policy shall not be considered as part of the value insured in event of loss or damage.

It is also understood and agreed that on demand of this Company, in the event of loss, the insured shall, "to protect the property from further damage," promptly pay all government duties, warehouse and other charges necessary for the purpose of removal of said merchandise to such other location as may be designated by this Company.

In view of the statute providing for remission or abatement, and the well settled policy of the Treasury Department in interpreting it, there does not appear to be any particular necessity of insuring the duty, and to pay premium on this additional valuation would be an expense without compensating benefits commensurate with the outlay.

The question as to the proper form to use when property is sold under contract is one concerning which there is considerable misapprehension, a great many entertaining the erroneous belief that so long as the legal title remains in the vendor, he is the owner of the property and that it should be insured in his name.

Where the contract is silent upon the subject, courts differ as to whether the vendee must complete, despite the intermediate destruction of the building by fire. The English rule, followed by some other courts, is, in general, that the vendee, whether possession has been given or not, is to be regarded as the equitable owner, liable meanwhile for all losses and entitled to all benefits, if not in default under the

terms of the executory contract, and that destruction of the building by fire is no bar to an action for specific performance of the contract of sale. But the tendency of decisions in this country lends support to the rule that the executory contract falls at the option of the vendee, if the vendor cannot deliver the premises in substantially as good condition as when the contract was made. (Browning v. Home Ins. Co., 71 N. Y. 508; Wood v. American Fire Ins. Co., 149 N. Y. 372; Tieman v. Citizens Ins. Co., 76 App. Div. 5; O'Neill v. Franklin Fire Ins. Co., 159 App. Div. 313.)

But where the vendee has, in addition to his executory contract, and pending its fulfillment, *taken actual possession* and control of the property and is in a position to enforce specific performance, it has been quite generally held that he is the equitable or real owner of the property. It is vendible as his, chargeable as his, capable of being encumbered as his; it may be devised as his, would descend to his heirs, and while living is insurable as his. The vendor who retains the legal title simply has a lien on the property for the unpaid balance due on the contract; the substance of ownership has passed—only the shadow remains. As the vendee under these conditions can insure the property for its full value as his own, it logically follows that the vendor cannot insure it as owner, for it can hardly be maintained that there can be two sole and unconditional owners of the same property at the same time. Therefore, a New York Standard Policy which contains a stipulation against change in interest, title or possession becomes void unless properly endorsed, if the property is sold under contract and the vendee is given possession. (Sewell v. Underhill, 197 N. Y. 168, affirming s. c. 127, App. Div. 92; Brighton Beach Racing Ass'n v. Home Ins. Co., 113 App. Div. 728, affirmed without opinion, 189 N. Y. 526.)

"When the vendee under an executory contract binds himself absolutely to complete and to take the whole title, whether of real or personal property, he is held to be the sole and unconditional owner. But where the agreement to purchase is conditional or contingent, whether of real or personal property, so that a fire loss will not fall upon the vendee, then his interest is not sufficient to satisfy the warranty as to sole and unconditional ownership. The beneficial owner of the entire property is the real owner." (Richards on Insurance, 3rd Edition, 336.)

If it is desired to protect the interest of the vendor only, it can be done by issuing policy in his name, but it is absolutely necessary to state therein that the property has been sold under contract or that a bond has been given for a deed. The only interest the vendor has left to protect is that of a vendor's lien (an interest somewhat similar to that of a mortgagee), and upon payment of the loss, which cannot exceed the unpaid balance due on the contract, the insurance company will be subrogated to the extent of the amount paid.

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If it is desired to protect the interest of the vendee only, the policy should be issued in his name just as if he also held the legal title. It is customary to state in the policy form that he holds a bond for a deed or a contract of purchase, although under a New York Standard Policy this would hardly seem to be necessary .

If it is desired to protect the interest of both vendor and vendee it can be done by issuing the policy in the names of both and stating therein that the property has been sold under contract by one to the other, and making loss, if any, payable as their respective interests may appear.

A policy issued to the vendor setting forth the fact that the property has been sold under contract to the vendee (naming him) and making loss if any payable to each as their respective interests may appear, would probably be held to indicate an intention to cover both interests, although this is getting the cart before the horse and would be analogous to issuing a policy in the name of the mortgagee with loss if any payable to the mortgagor. If both interests are intended to be covered the policy should so state.

A policy issued in the name of the vendee in possession, with loss if any payable to the vendor, as his interest may appear, with a mortgagee clause attached, is probably the best protection that the latter can possibly have.

The law in Maine is a notable exception to the general rule. In that state, even if the vendee be in possession, if the building is destroyed by fire the vendee cannot be compelled to take a deed of the land alone and pay the purchase money.

Gould vs. Murch, 79 Me., 288.

In Georgia, by reason of the "Georgia Loan Deed" statute, when the property has been sold under contract, neither the vendor nor vendee is deemed the sole and unconditional owner of the property; hence it is absolutely necessary that the interest to be insured be fully set forth in the form.

Orient Ins. Co. vs. Williamson, 98 Ga., 464.
Williamson vs. Orient Ins. Co., 100 Ga., 791.
Palatine Ins. Co. vs. Dickenson, 116 Ga., 794.
Athens Mut. Ins. Co. vs. Evans, 132 Ga., 703.

Some forms contain a stipulation that the policy shall not be invalidated if contracts for sale of the property are executed and delivered. This will save the policy from forfeiture, but it will only cover the remaining interest of the vendor.

Several years ago the Uniform Bill of Lading was adopted by railroads and other transportation companies, with the endorsement of the Interstate Commerce Commission acting in an advisory capacity. The only provision therein of special interest to insurance companies reads as follows: "Any carrier or party liable on account of loss of

or damage to any of said property shall have the full benefit of any insurance that may have been effected upon or on account of said property, so far as this shall not avoid the policies or contracts of insurance." The insertion of the closing words of this last paragraph was secured through the efforts of marine underwriters, who lost no time in preparing suitable clauses to counteract the effect of the insurance provision.

From the various warranties prepared by marine companies to meet the situation, the following have been selected:

> Warranted by the insured free from any liability for merchandise in the possession of any carrier or other bailee who may be liable for any loss or damage thereto, and any stipulation or agreement that such carrier or bailee shall have the benefit of this insurance, shall void this policy or contract of insurance.

also,

> Warranted by the assured free from any liability for merchandise in the possession of any carrier or other bailee, who may be liable for any loss or damage thereto; and free from any liability for merchandise shipped under a Bill of Lading containing a stipulation that the carrier may have the benefit of any insurance thereon; and that any insurance against fire granted herein shall not cover where the assured or any carrier or other bailee has fire insurance which would attach if this policy had not been issued.

Fire insurance companies have apparently taken no action toward protecting themselves in this direction, and unless they do so the insurance issued by them will inure to the benefit of the carrier. Although the Supreme Judicial Court of Maine in the case of Dyer v. Maine Central R. R. Co. (99 Me. 195) held that an insurance provision in the statute of that State in favor of a railroad company will not deprive an insurance company of its subrogation rights in event of negligence, the Supreme Judicial Court of Massachusetts, in a recent decision under a similar statute, held to a contrary doctrine; New England Box Co. v. N. Y. C. & H. R. R. R. Co. (41 Ins. Law Journal, p. 517; 99 N. E. Rep. 140). And the United States Supreme Court has held that a stipulation in a bill of lading that the carrier shall have the benefit of any insurance on the goods is a valid one, and in such a case, even though the loss be occasioned by the negligence of the carrier, the insurance company cannot be subrogated to the rights of the shipper to recover damages for such negligence; Phoenix Ins. Co. v. Erie & Western Transportation Co. (15 Ins. Law Journal, p. 574; 117 U. S. 312).

The recent action of the New York Insurance Exchange in abrogating the old pattern clause and requiring patterns, models, moulds, matrices, drawings, designs, dies, solutions, photographic negatives or lithographic plates or stones or engravings thereon to be specifically covered, and in preparing a clause precluding the possibility of their being covered by general terms under other items of the policy, was a move in the right direction, and the rule should be universally adopted not only as a matter of sound underwriting practice,

but in the interest of convenience in adjustments and as a matter of simple fairness between the insured and the company. All of the articles mentioned are of uncertain value and belong in a class by themselves; and to include them with machinery and fixtures, the value of which is easily ascertainable, invariably complicates the adjustment, especially when the policies contain the full co-insurance clause with no limit on the articles in question, for the oldest adjuster present never heard of a poor horse (covered by insurance) ever being killed by lightning or a dead pattern ever being destroyed by fire.

A case is now pending in a distant city under the following conditions: blanket policies were issued for over $150,000, with full co-insurance clause, and no limit on patterns. A comparatively small fire occurred in the basement of one building belonging to the plant which was used for the storage of patterns and drawings. If the fire had occurred in some other part of the plant, the probabilities are that, in figuring value for purposes of co-insurance, the basement of the burned building would have been regarded as a sort of pattern cemetery, but through the revivifying influence of the fire the patterns and drawings therein instantaneously assumed a valuation of about $50,000, or about one-third the value of the entire plant and contents.

In naming a specific amount on patterns and drawings, the company knows just what it is doing and just what to expect; in insuring them blanket without limit, it ought to know from experience what to expect, although it does not know just what it is doing.

The precaution taken by the framers of the pattern clause to avoid having patterns and other kindred articles covered by general terms in other items of the policy, directs attention to the fact that in preparing any kind of form, special care should be taken to have each item embrace exactly the property intended to be protected by it, and neither by general nor specific terms have the same property covered under more than one item. As there are a number of exceedingly broad general terms such as "supplies," "appurtenances," etc., they should be used exactly where intended and not elsewhere.

Among the new elements which have been introduced into policies of fire insurance during the past thirty years, by far the most important is that of co-insurance, which has its practical manifestation in various forms familiarly known as the "eighty percent co-insurance clause," "the percentage average clause" and "the reduced rate contribution clause." Co-insurance is fundamentally sound in principle and an absolutely necessary factor as an equalizer of rates; and although by some strange providence it almost invariably happens that the relative sound value of property saved is much less than that destroyed, yet the co-insurance or average

clause, by maintaining a proper relation between sound value and loss, operates in a large measure as a kind of automatic regulator in loss adjustments.

Co-insurance, or average conditions, if a proper amount of insurance be carried, are in themselves perfectly harmless, but if used in connection with the average distribution clause, special care should be taken by the insured or his broker to see that all policies are strictly concurrent and that all contain the average distribution clause, for if some contain the clause and others do not, the insured may be compelled to stand a portion of the loss himself, notwithstanding the fact that the aggregate insurance may exceed the aggregate value. All the policies should contain the average distribution clause or none of them should. 6

Policies are sometimes issued to John Doe and/or Richard Roe. A policy so issued may cover one, two or three distinct interests in the property described therein, to wit:— It may cover the interest of John Doe individually, the interest of Richard Roe individually, and the interest of both jointly. But if the policy be subject to co-insurance or reduced rate average conditions, it is only proper that the combined value of all the interests should be taken as the basis for their application.

Although the form "John Doe and/or Richard Roe" has come into use quite generally during recent years, it is doubtful whether it is any broader in its cover than a policy issued to "John Doe and Richard Roe, as interest may appear"; in fact, good argument might be advanced in support of the view that a policy so issued would be more comprehensive and protective to the insured than one issued to "John Doe and/or Richard Roe," unless the latter should also contain the words "as interest may appear."

If one of the parties violates the conditions of the policy it will be void only as to his individual interest, and might be as to the joint interest, but not as to the individual interest of the party not participating in the violation. A possible exception to this general statement should perhaps be noted, for it may be that the few states which have declared unqualifiedly in favor of the doctrine that the policy is indivisible, and those which have decided in favor of conditional indivisibility, may hold that if it is void as to one interest, it is void as to all. It is also possible, however, that they might differentiate a policy covering several different interests from one covering several different items. Most of the states, however, which have passed on the question have held to the view that the policy is divisible, notwithstanding the plain provision, "This entire policy shall be void, etc." This opinion evidently assumes that sufficient significance is given to the word "entire" if it is construed as applicable to specific items of the policy instead of the entire instrument.

The question is frequently asked as to how a draft in payment of a loss under a policy so issued should be drawn in order to fully protect the company. The opinion is quite general among underwriters and adjusters that when paying a loss the draft should be made out precisely as the policy is written, without any variation or shadow of turning, and as a general rule this is correct. But is this true in respect of a policy issued to "John Doe and/or Richard Roe?" The answer to this question depends on the answer to two others:

First:—Does a draft so drawn require the endorsement of both parties, or can the insurer be legally compelled to honor it upon the endorsement of either?

Second:—If a draft so drawn is honored upon the endorsement of one of the parties only, will the insurer thereby secure a full release, or can it be compelled to respond to a subsequent claim by the party who did not endorse the draft?

The opinion seems to be that the endorsement of one of the parties will be sufficient to enable said endorser to collect, and that the insurer will not be relieved of liability in respect of any later claim by the other party to the contract. If these conclusions be correct, it is evident that the insurer cannot safely issue a loss draft in the manner indicated, and that in the absence of a written release or authorization from one of the parties, the draft should be issued in the names of both "John Doe and Richard Roe," omitting the word "or."

If the draft is drawn in the name of "John Doe and/or Richard Roe," several possibilities present themselves, to wit:

(1) If the loss is confined to the property belonging to one party only, who files his claim, and the draft falls into the hands of the other party, who collects on his own endorsement, the company is not released.

(2) If claim is made by both parties for loss on property belonging to each individually, and the draft is endorsed by one only, who makes collection, the company is not released as to the interest of the other.

(3) If claim is made by one or both parties for loss on personal property belonging to both jointly, and the draft is endorsed and collected by one only, the Company is released as to the joint property. This, however, is not necessarily so with respect to real property.

(4) If claim is made by one party only for the full face of the policy, for loss on property belonging to himself individually, and the draft is endorsed by him only, and collection made, and if a later claim is also made for the full face of the policy by the other party for loss on his individual interest in the property, the insurer would be compelled to pay the second claimant to the extent of his ratable interest in the policy. In other words, in such circumstances the insurer will have the privilege of paying out probably one hundred and fifty percent of its policy in settlement of the two claims.

(5) If claim is made by one party only for loss on his individual interest in the property, and the other party gives a release or authorizes payment to the first party, the draft could with perfect safety be made payable to said first party only, or it could be made payable to both jointly, in the form "John Doe and Richard Roe," but it would not be absolutely safe to issue it in the names of both with the conjunctions "and/or" for, as above stated, if it should happen to fall into the hands of the wrong party, who endorses and collects, the company would not be released.

Is the property-owner absolutely safe in accepting a policy in the form "John Doe and/or Richard Roe?" This depends on circumstances. Assuming that the value of all interests must be the basis for the application of co-insurance conditions in all cases, if both parties to the contract are so situated with respect to the property that they are at all times fully posted as to the total value at risk, so that the amount of joint insurance can be regulated in accordance with their co-insurance necessities, they have nothing to fear on that score, but if either one or the other is not so situated, he runs the risk of being a co-insurer in the event of loss.

In those states which have held unqualifiedly that the policy is divisible the assured may safely accept policies in the form "John Doe and/or Richard Roe," but in those states which have held to the contrary, one party may possibly be running the risk of having the entire contract rendered void by some act on the part of the other.

It is for the parties insured to determine for themselves whether or not the advantages of this form outweigh the disadvantages, but when a policy is so issued the insurers are entitled to a full and complete release in the event of loss, even though the giving of same may at times cause one or both of the parties some inconvenience.

The safest course, and in fact the only absolutely safe course for the insurer, is to issue the loss draft in all instances in the form "John Doe and Richard Roe," thereby securing a release as to each individual interest, and the joint interest if any.

Virtually every insurance company doing business is requested with more or less frequency, when the loss is less than $100, and sometimes when it is more, to eliminate from the loss draft the name of the mortgagee to whom the loss is payable, on account of the difficulty attendant upon securing his receipt and endorsement. In most instances this can be done with comparative safety, but inasmuch as the loss payable clause is placed on the policy at the request of the insured, the insurance company should not be asked to ignore the request after it has become a contractual obligation and assume all responsibility therefor. The possible inconvenience connected with securing the mortgagee's release is well known when the policy is issued, and if the parties do not desire

small losses paid to the mortgagee, it can be very easily arranged by making loss if any above a certain fixed amount payable to him as his interest may appear, and in some instances this is done.

If a policy covers on building and stock under separate items and it is the desire of the parties that the loss if any on building only shall be payable to a third party, it should so state, otherwise the loss under the entire policy will be payable to him.

Is the insurer liable for loss when a property owner has released a railroad company from liability? When the insured has, *prior to issue of the policy,* released a railroad company or wrongdoer from liability for fire due to negligence or other cause, and fails to advise the insurer of such release, has he concealed or misrepresented any material fact or circumstance which precludes recovery from his insurer; in other words where the insured has by his own act deprived the insurer of its subrogation rights, is it a good defense to an action on the policy?

In England in the case of Tate v. Hyslop (1884, 15 C. B. Q., 3688 Eng.), the Upper Court reversed the finding of the Lower Court and held that when the insured released the common carrier from liability (except negligence) and knew or should have known that the underwriters charged a higher premium on goods carried under such conditions, the insured's failure to disclose such release would (and in this case did) defeat recovery from the underwriters.

There are several American decisions bearing on the subject, among which may be mentioned the following:

Pelzer v. St. Paul F. & M. Ins. Co., U. S. C. C. 19 Ins. Law Journal, p. 372; 41 Fed. 271;

Pelzer v. Sun Insurance Office, South Carolina S. C. 21 Ins. Law Journal, p. 952;

Greenwich Ins. Co. v. L. & N. Ry. Co., Ky., 1902. Vol. 31 Ins. Law Journal, p. 298; 112 Ky. 598; 66 S. W. 411.

The Courts of this country have not been as generous to the underwriters as the English courts, but from an analysis of the decisions, we feel warranted in drawing the following conclusions, viz:

Such agreements are valid if there is a proper consideration therefor; and they are not against public policy.

When the insured has, previous to the fire, and before the issue of the policy, released the railroad company from liability and neglected to disclose such fact to the insurer when applying for insurance, it is a question for the jury to determine whether the failure to make such disclosure was concealment of a material fact, and where the insurers discriminate against property subject to such release to the extent of charging a higher rate, and this fact is known to the insured, but not to the insurer or his agent, and he fails to pay the higher rate and have notice of release endorsed on the policy, there would be a reasonable chance of defeating

the claim on this ground; but where there is no such discrimination on the part of the companies, it would seem that the insurer would have no hope of a successful defense.

All courts which have passed on the question, with the exception of the Supreme Judicial Court of Massachusetts, the Court of Errors and Appeals of New Jersey, the United States Supreme Court and the English Courts (all of very high caliber), have decided that a fact known to an agent at the time the policy is issued cannot be taken advantage of by the insurer as a defense, but most courts have held that a fact coming to the knowledge of an agent after a policy has been issued, must be endorsed in writing on the policy in order to be binding upon the insurer.

If, therefore, the agent of the insurance company is aware of the fact that a release has been given by the property owner to the railroad company when he issues the policy, the insurance company, in most states, would be estopped from setting up this fact as a defense, but in the states of Massachusetts and New Jersey, or where a case might be transferred to the Federal Court, the insurance company could take advantage of this defense.

When, after the issue of the policy, the insured enters into a contract with a railroad company, agreeing to hold it harmless from any liability from loss by fire, there can be no recovery against the insurer (Down's Farmers Warehouse Association v. The Pioneer Mutual Insurance Association, Washington, S. C., 35 Ins. Law Journal, p. 273).

It is the practice of the insurance companies to make an extra charge of from five to fifteen percent of the annual premium in the Northern States, and as high as twenty-five percent in the Southern States, on account of the existence of such agreements and notwithstanding the well-known inclination of the courts to favor the insured, it would be the part of wisdom for him to pay the additional premium and be fully protected by having the following endorsement made on his policies: "In consideration of $......................., additional premium, notice is hereby accepted that the assured has waived the right of recovery from..............for any damage by fire occurring to the property described herein or affected thereby."

There are two kinds of insurance which have in recent years become quite popular, to wit: Use and Occupancy Insurance and Profit Insurance.

The term "Use and Occupancy" is somewhat vague and indefinite. It usually involves the idea of earnings and profits, but they are not necessarily synonymous terms. Use and Occupancy Insurance is analogous to Rent Insurance or Profit Insurance, but it is broader than either, as the insurance companies discovered in the Buffalo Elevating Company case several years ago (Michael v. Prussian National Insurance Company, 171 N. Y. 25), where the Court permitted the in-

sured to collect over $60,000 for an alleged loss of use, a large part of which was not really sustained, for the insured, as members of a pool, composed of many elevator owners, was by agreement to receive, and subsequently did receive, their full share of the pool earnings in spite of fire destroying the elevator in question.

Use and Occupancy Insurance is adapted more particularly to manufacturing risks and Profit Insurance to mercantile risks, although it is customary for manufacturers to take out Profit Insurance on finished goods, sold or contracted for. There has been a feeling, which still exists in some quarters, that this class of insurance has a tendency to increase the moral hazard, but probably on account of the discriminating care on the part of the insurers in selecting their risks, the record thus far has failed to justify these fears.

This class of insurance should not be written indiscriminately. In fact it would seem to be against public policy for it to become universal. It should not be granted to any individuals, firms, or corporations, except those of the highest standing, doing a profitable business, and it calls for the utmost good faith on the part of the contracting parties.

In a distant city some time ago, a comparatively small fire occurred in the assembling department of a large manufacturing plant which consisted of sixteen buildings. This department was the one which of all others, could be shut down and discommode the insured the least, and on the basis of the payroll, it constituted as a factor in production a little over five percent of the plant.

The adjusters figured the actual use and occupancy loss at less than $1,000, but claim was presented for $27,000 or $9,000 per day for three days, just as if the entire plant had been thrown out of commission; and in addition to this, $9,000 for profit on stock which had been destroyed, making a total claim of $36,000 which modest figure was subsequently raised by the filing of amended proofs for $61,000.

The form provided that if any of the buildings or the contents thereof should be so damaged, destroyed or disabled as to entirely prevent the insured from producing "finished goods," the companies should be liable per day for each working day of such prevention, for an amount not exceeding the net average daily yield of the plant for three hundred working days immediately preceding the fire. It also contained the usual provision in regard to partial prevention. It did not, however, contain any element of co-insurance and the insurance actually carried amounted to only thirty-five percent of the annual net profits.

The insured contended, not that they were entirely prevented from carrying on their business of manufacture, but that they were entirely prevented from producing "finished goods"—as if the production of finished goods did not require the use of the entire plant, but only the finishing department.

During these three days they were producing finished engines, finished transmissions, finished bodies, and all such parts, but in the opinion of the insured's counsel, all this counted for naught, because they were in the business of producing finished automobiles.

The claim was finally compromised for $10,000, but if the word "finished" can, in a given case engross the attention of three firms of attorneys, consume several thousand dollars in expenses, and protract the adjustment of a three days' partial loss for fifteen months, it would surely seem as if it were a good one to eliminate from the use and occupancy form.

There are many use and occupancy forms in current use which it will be impossible even briefly to analyze. In fact, use and occupancy insurance and the kindred subjects of rent, rental value, leasehold and profit insurance if fully considered, each possesses in itself sufficient material for a special paper.

When insuring commissions and/or profits the form should limit the liability of the insurer to not exceeding a certain percent of the sound value of the stock, and it should also contain a stipulation that the loss of commissions and/or profits shall not, in any event, exceed said percent of the amount of damage which the merchandise itself shall be found to have sustained, irrespective of whether said damage be ascertained by agreement, by appraisement, or whether the stock be surrendered to the companies covering same, and the net loss ascertained through sale of the salvage. The policy should also be subject to average or co-insurance conditions.

The following "market value" clause is now frequently used in connection with lumber risks:

> It is understood and agreed that in event of loss or damage to lumber the basis of settlement and application of the average (co-insurance) clause shall be the market value at............the day of the fire, less cost of transportation and marketing at the time and place of fire.

The following is used in polcies covering on stock in tanneries:

> It is understood and agreed that in the event of loss or damage to the property hereby insured the basis of settlement on tanned leather, finished, unfinished or in the rough, shall be the market price of similar leather in Boston, Mass., the day of the fire, less cost of finishing and transportation.

and somewhat similar clauses are inserted in policies covering on whiskey, sugar and other staple products in the hands of a manufacturer.

The Supreme Court of Michigan, in 1892 (Mitchell v. St. Paul German Ins. Co., 92 Mich. 594), and the Texas Court of Civic Appeals, in 1898 (Hartford Fire Ins. Co. v. Cannon), decided that the basis of indemnity for lumber is the market value. The Supreme Court of Pennsylvania had decided that the "Actual cash value of sewing machines was the cost to

the insured, who was a manufacturer, to reproduce them." (Standard Sewing Machine Co. v. Royal Ins. Co., 201 Pa. State, 645.) But when the same Court ran up against whiskey, because of the peculiar nature of that commodity, it staggered and fell into the market value column. (Frick v. United Firemen's Ins. Co., 218 Pa. State, 409.)

The United States Circuit Court of Appeals followed with a similar decision (Mechanics Ins. Co. v. C. A. Hoover Distilling Co., vol. 40 Ins. Law Journal, p. 347; 182 Fed. 590), so that unless the parties to the contract agree that the words "actual cash value" and "costs to replace," as applied to goods in the hands of a manufacturer, shall be construed to mean "cost to reproduce," there appears to be no good reason why the market value clause should not be used in policies covering on lumber and whiskey at least, for it is more than probable that other jurisdictions will follow the precedents already established and that the companies will be under the necessity of settling future losses thereon on that basis, whether the policies contain such a provision or not.

To just what extent the judicial inclination may feel impelled to go in favor of market value as applied to goods in the hands of a manufacturer in construing the New York Standard Policy remains to be seen, but in the meantime the market value clause should not be inserted in policies issued to manufacturers except on risks where the companies would, if liability were limited to cost of production, be perfectly willing to write profit insurance. After all, the difference between having cost of production and profit merged in one set of policies and having policies covering each separately is not very great; in fact, in principle, the difference is the same as that between blanket and specific insurance, and in cases where insurance of both cost and profit are not objectionable, the terrors of the market value clause would be in a large measure neutralized by average or co-insurance conditions, and no such risk should be written unless subject to such conditions.

It would be interesting to consider forms covering common carrier liability, improvements and betterments, leasehold interest, mortgagee's interest, rents, rental value, reinsurance; also clear space, iron safe and three-fourths value clauses; policies issued to heirs, administrators, estates, etc. But it was difficult enough to know where to begin this subject, and it is still more difficult to know where to stop.

In general, policy forms contain many superfluous words. For instance, in that relic of the past commencing: "On household and kitchen furniture, useful and ornamental," five words out of the eight are unnecessary, and in that other inheritance from our ancestors, reading: "On merchandise, hazardous, non-hazardous and extra hazardous," six words out of the eight are redundant, and the same criticism will apply to a large majority of the forms in current use. The

longest form may afford the shortest indemnity, and a good form can be very materially weakened by the injudicious addition of words, although it is better to use too many than too few. Vital points should be covered and useless phrases omitted. The three graces of the ideal insurance form are clearness, conciseness and completeness.

One of the best things in the New York Standard Policy is on the back of it: "It is important that the written portions of all policies covering the same property read exactly alike. If they do not, they should be made uniform at once." If proper attention were given to this admonition, the vocation of the apportionment expert would be gone and some of the troubles that now vex us would be at an end.

USE and OCCUPANCY INSURANCE

AN ADDRESS

DELIVERED BEFORE

The

Fire Insurance Society

of Philadelphia

November 18th, 1912

BY

W. N. BAMENT

General Adjuster

THE HOME INSURANCE COMPANY

NEW YORK

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Use and Occupancy Insurance

William N. Bament, General Adjuster
The Home Insurance Company, New York

An Address Before the Fire Insurance Society of Philadelphia, November 18, 1912

Since the first fire insurance policy issued by an American company was written in the city of Philadelphia one hundred and sixty years ago, insurance, the "handmaid of commerce," has gone steadily forward, keeping pace with the marvelous development of the country, and we now have the insurance business of today with its hundreds of millions of capital, ready to meet every legitimate requirement of our social, commercial and industrial life.

During the past thirty years a number of new elements have been introduced into the business of fire insurance, among the more important of which may be mentioned electricity for light and power, automatic sprinklers, co-insurance and the subject of this address, "Use and Occupancy Insurance."

Any discussion of this branch of the business would not be complete without a consideration of the kindred subjects of rent, rental value, and profit insurance; in fact, use and occupancy insurance embraces all the others and more, and the former bears about the same relation to the latter as blanket insurance does to specific. Some attention, therefore, will be devoted to these and also to the closely related subject of leasehold insurance.

The New York form of rent policy reads as follows:

"The intention of this insurance is to make good the loss of rents, caused by fire or lightning, actually sustained by the assured on occupied or rented portions of the premises which have become untenantable for and during such time as may be necessary to restore the premises to the same tenantable condition as before the fire; * * but this company shall not be liable for a greater proportion of any loss than the sum hereby insured bears to the actual annual rental of the entire occupied or rented portions of the premises."

The framers of this form no doubt thought that it was perfectly clear, but, nevertheless, several questions present themselves in connection therewith. First, what is meant by "loss of rents * * actually sustained by the assured?" Does this mean gross rents, as contended by some, and as frequently though not always construed in practice, or does it mean gross rents less those expenses which may be saved to the insured during the period of reconstruction, such as lighting, heating, elevator service, janitor service, collections, insurance and the like?

The Courts May Always Be Counted On

to construe the contract most liberally in favor of the insured, and if they should declare that this class of insurance is valued, the rents being fixed amounts usually set forth in leases, then in the absence of a stipulation in the contract to the contrary, it would be construed like any other valued policy and the insurer would be liable for loss of gross rent without any deductions therefrom.

Although it is possible that they may so hold, we are hardly warranted, in view of their strong inclination to adhere in their decisions to the fundamental principle of indemnity, in concluding that they would go out of their way to discover a valued feature in a policy form, where there is no evidence —except remotely inferential—of its existence. In fact, reason and justice would seem to point in exactly the opposite direction.

If the policy is not valued, it should be interpreted like any other contract of indemnity, and there is no more logical reason why one should recover more than his actual loss on rents than he should on any other kind of property. And the fact that the policy limits liability to loss on rents "actually sustained," lends emphasis to the view that the policy is not valued, and these words, if they have any significance whatever, should be controlling.

The highest court in England, speaking through some of the brightest minds that ever graced the King's Bench, is unanimous in standing for the principle that under a contract of fire insurance, the insured in case of loss, shall be fully indemnified, but shall never be more than fully indemnified; that the insured is not entitled to receive anything by way of indemnity, if he has in fact sustained no loss; that in order to ascertain what a loss is, everything must be taken into account which is received by and comes to the hand of the insured, and which diminishes that loss. And the United States Supreme Court has declared in equally emphatic language, "If a loss happens, anything which reduces or diminishes that loss reduces or diminishes the amount which the indemnifier is bound to pay." (Chicago, etc., R. R. Co. vs. Pullman Car Co., 139 U. S. 79-88.)

Massachusetts, which departed from the principle in connection with the interest of a mortgagee (King vs. State Mutual F. Ins. Co., 7 Cush., 1), in another case, speaking through its highest court, said: "The assured is only entitled to be put in the same condition pecuniarily that he would have been if there had been no fire." Two prominent decisions by the Court of Appeals of New York—Foley vs. Manufacturers' and Builders' Ins. Co. (152 N. Y., 131), and Michael vs. Prussian National Ins. Co. (171 N. Y., 25), have impressed many with the belief that said court has departed from the fundamental principle of indemnity, but a careful analysis of the opinions hardly warrants this conclusion. In the decision in the last named case, which will be referred to later, it was the valued feature that over-indemnified the insured.

In the light of the authorities referred to, it is clear that unless the policy is a valued one, it is incumbent upon the insured, under a rent policy, to prove what his actual net loss is, after making proper deduction for everything in the way of salvage which may come to him.

In many cases there would be no diminution in the regular running expenses, but in event of a serious damage to or the total destruction of the building this might be a very important factor.

The Average Condition at the End of the Rent Clause is not necessarily inconsistent with the foregoing basis of recovery, but in event of deduction being made from the gross loss for salvage in expense of maintenance during reconstruction, equity would suggest a corresponding modification in the value when applying the average condition.

Nearly if not all rent losses are partial; the present forms, which differ somewhat in various portions of the field, have been in use for many years; the loss record has not been unfavorable; very little difficulty has been experienced in adjustments; settlements are usually made on a compromise basis, and many claimants no doubt take into consideration the salvage in expenses in their adjustment negotiations, so that this question does not arise very frequently as a practical proposition. A form could doubtless be prepared which would eliminate the element of doubt, which in the minds of many surround the present ones, yet the attempt would present its difficulties, and unless we experience more trouble in the future than we have in the past in the adjustment of this class of losses, and unless the necessity for a change becomes more apparent than it has up to the present time it would be advisable to let it remain as it is.

Another inquiry which suggests itself is whether, under the above form, if certain portions of the premises are occupied by the landlord himself and not rented, the insurer would be liable for the rental value thereof. The term rent is hardly applicable to this condition, and the phrases "loss of

rent actually sustained" and "actual annual rental" tend to confirm this view. This condition should be covered under a rental value policy or as an element of use and occupancy insurance. But the particular form under discussion covers "occupied or rented portions," and this would in all probability be held to include occupancy by the insured.

Rental Value Policies

are written at an advanced rate to cover loss of rents or rental value of the premises whether occupied or vacant at the time of the fire. The theory upon which this class of insurance is based is that the premises have a value as rentable property and may be rented at any time; hence, if destroyed by fire the insured may be deprived of the income which would otherwise accrue to him. It will also cover the rental value of that portion of the premises occupied by the owner himself. If not valued the amount of loss under a policy of this nature must necessarily be established by extraneous evidence.

If it is the intention of underwriters to cover the occupancy by the owner of the building under the rental value and not under the regular rent form (occupied only) in use in New York city, they can find room for improvement in the latter in respect of the words "occupied or rented," to which reference has been made.

Leases Contain All Sorts of Conditions,

and forms of policy covering leasehold interests are correspondingly varied. Under certain conditions a landlord and tenant may both have an insurable interest in the subject matter for its full value, and unless he has otherwise been fully indemnified each may recover from his own insurers the full value thereof. The landlord has an insurable interest as owner and if his tenant is under covenant to repair he is exposed to the risk of his tenant being unable to fulfill his obligation. On the other hand, a tenant who is under covenant to repair or restore the building in case of fire, has an insurable interest both by reason of his right to use the demised premises and by reason of this assumed liability to restore, and he cannot be fully indemnified in event of the building being destroyed by fire unless he recovers from his insurers the full value thereof. This does not constitute double insurance, and there is no right of contribution, as the interests are separate and distinct.

This would seem to imply a possible double indemnity, but the equitable doctrine of subrogation has been adopted to prevent this, and the great English decisions give this doctrine the widest scope and application by placing the insurers in the position of the insured upon payment of the loss, and giving them the advantage of every right or remedy whether in contract or in tort, or otherwise, which the insured himself may have.—Castellain vs. Preston (1883), 11 Q. B. D., 380; Darrell vs. Tibbitts (1880), 5 Q. B. D., 560.

There is probably nothing stronger in the language of any court than Justice Brett's elucidation of the doctrine of subrogation as set forth in these decisions, in support of the principle that the insured is entitled to a full indemnity, but nothing more. This reasoning is so sound fundamentally that it is impossible to conceive of any court clothed in its right mind rendering an opinion at variance therewith.

There is a case in point in New York city, where the owner of a certain building carries insurance thereon (including improvements made by lessee), for its full value, several hundred thousand dollars. The lessee who is liable for rent and for all repairs, unless he avails himself of the statute and surrenders the premises, also carries a large insurance covering his interest. Four losses have occurred during the past few years, all of which have been paid by the lessee's insurers, no claim being made against the insurers of the lessor.

There are a Number of Other Conditions

supporting an insurable interest on the part of the lessee. He may have paid the full rental in advance with no right of abatement; he may have obligated himself to pay rent during the entire term of the lease even though the premises should be destroyed by fire. He has the right to the use and enjoyment of the demised premises. Very frequently the premises are sublet at a profit, and insurance may be taken out by the lessee to cover that interest; or he may occupy the demised premises himself, and owing to an advance in the value of the leasehold interest he may take out insurance to cover this increased value.

One of the most common forms of leasehold insurance is valued, and provides that if the premises shall be totally destroyed by fire the company shall pay the whole amount insured, less a deduction of a stated amount per month for the time that shall have elapsed between the date of the policy and the date of the fire. And in case of damage the company shall pay at the rate of a stated amount per month until by the exercise of due diligence the premises can be made tenantable. As in the case of all valued policies, care should be taken to ascertain whether the facts or conditions warrant the valuation stated in the contract.

The following comes from a Western city:

"A, the owner, leases the building to B; he sublets to C, and he in turn sublets to D, for the unexpired term of ten years; D agrees to pay a stated rental, and in addition to this a bonus of $50,000, in annual instalments of $5,000 each. In event of total destruction of the building by fire the lease may be canceled at the option of either lessor or lessee, but the above bonus is to be paid in any event, and D takes out insurance to cover this liability. A, no doubt, has policies covering the building and rents. B probably has insurance

covering his profit on the lease, and C, who may not care to rely absolutely upon the agreement with D, may also have insurance covering his profit."

We have here a chain of insurable interests which may be extended indefinitely, fairly rivaling in its possibilities the famous house that Jack built.

In Chicago a hotel company took out policies covering on the use and occupancy of a hotel, the loss to be computed from the date of the fire to the time when, by the exercise of due diligence, the building could be rebuilt. After the fire the lessor exercised his right to cancel the lease, there being 164 days still to run. The building could have been repaired in eighty-four days, but the insured brought suit claiming indemnity for 164 days. The court very properly held that the insured could collect for only eighty-four days. The hotel company should have taken out insurance on its leasehold interest instead of use and occupancy insurance.

Insurance Is Frequently Written covering buildings standing on leased ground, and under the policy conditions it is absolutely necessary for this fact to be indorsed thereon. It is self-evident that if a company writes a policy covering a building on leased ground, with the lease on the verge of expiration, with no privilege of renewal and with no option of sale to the lessor, it is tempting fate and playing with fire.

The Supreme Judicial Court of Massachusetts (two justices dissenting) has held that the lessee of the land who erects a building thereon, which reverts to the landlord at expiration, has an insurable interest in the building for its full value, although the lease has only two years to run, the policy, of course, stating that it is located on leased ground. (Fowler, et al. vs. Springfield F. & M. Ins. Co., 7 Ins. Law Journal, p. 189.)

The New York court, however, under a similar state of facts, held that while the lessee had an insurable interest, it was not for the full value of the building but for the value of the tenement for occupation, subject to rent, during the unexpired term. (Niblo vs. North American Fire Ins. Co.. 3 N. Y., Superior Court, p. 551.)

The New York Court has also held that when, under the terms of the lease, the lessee had the right, at expiration, to remove the building erected by him, the lessor had no interest therein, and that the lessee was entitled to collect the full value thereof, notwithstanding the fact that the lease had only seventeen days to run when the fire occurred, and if removed, it would net the lessee only about 20 per cent. of its value. (Laurent vs. The Chatham Fire Ins. Co., 1 Hall R., 41.)

Profits and/or commissions must be insured as such, although in respect of lumber in the hands of a mill owner, and whiskey in the hands of a distiller, the insurer is liable

for market value, which, of course, includes the manufacturer's profit. "Market value" clauses are now frequently inserted in policies covering on leather, whiskey, lumber, sugar and other staple products in the hands of producers and this is virtually assuming liability for loss on profits in addition to the cost of producing the goods. Just how far this class of decisions or this practice may extend it is impossible to predict, but in cases where the insurer would readily write profit insurance and literally run after use and occupancy insurance, the market value clause may be viewed with comparative equanimity, provided it is accompanied by that automatic regulator—a co-insurance or reduced rate average clause.

When insuring commissions and/or profits, the form should limit the liability of the insurer to not exceeding a certain per cent. of the sound value of the stock, and it should also contain a stipulation that the loss on commission and/or profits shall not, in any event, exceed said per cent. of the amount of damage which the merchandise shall be found to have sustained, irrespective of whether said damage be ascertained by agreement, by appraisement, or whether the stock be surrendered to the companies covering the same, and the net loss ascertained through sale of the salvage.

This may not in some instances be entirely fair to the insured, whose actual loss of profits may materially exceed the figure thus ascertained, but it affords an easy method of adjustment and is probably as liberal a contract as the companies can safely issue.

The advent of automatic sprinklers, the prompt recognition by the New England mutual insurance companies of their value as the greatest of all agencies in the line of fire protection, and the failure on the part of stock companies to recognize their importance as an underwriting factor, resulted in the transfer of a large portion of the insurance on textile mills in New England from stock to mutual companies. And it was with a view of counteracting this diversion that Mr. Henry R. Dalton, of Boston, and Mr. A. W. Damon, president of the Springfield F. & M. Insurance Company, devised the first use and occupancy form of which we have any record.

The Phrase "Use and Occupancy"

is somewhat vague and indefinite, and it is difficult to define with precision. It usually involves the idea of earnings or profits, but they are not necessarily synonymous terms. The New York Court of Appeals has attempted to define it in one of the few cases bearing on the subject, under a form simply covering "use and occupancy" without any descriptive terms.

The case referred to is the celebrated one of Michael vs. Prussian National Insurance Company (171 N. Y., p. 25), which in any discussion of the subject requires special consideration. The policy was a valued one providing for the

payment of a certain fixed amount for every day required for reinstatement. The insured, the Buffalo Elevating Co., which owned and operated a large elevator in Buffalo, entered into a secret pooling arrangement for the active season with other elevator owners, the agreement providing that after payment of certain operating expenses, the balance, to wit, 80 per cent. of the gross earnings of the Buffalo Elevating Co. should be turned over absolutely to the pool, and that the Elevating Company should continue to receive its full share of the entire pool earnings, even though their elevator should be destroyed by fire. The time required for rebuilding was fixed by arbitration at 259 days, and the total claim under 46 policies amounted to $60,328.87. The companies defended on the ground that there had been a change of interest in the subject of insurance and that the insured was not the sole, unconditional owner of the same.

The court held that, notwithstanding the transfer of the total earnings to another, the insured was the sole and unconditional owner under a use and occupancy policy, that there was no change in interest in the subject matter described in the policies, and that the doctrine of equitable subrogation did not apply. The court said:

"Use and occupancy, as terms of insurance, may assume within their general scope, the expectation of profits and earnings derivable from property, but the terms appear to have a broader significance as to the subject of insurance, and to apply to the status of the property and to its continued availability to the owner for any purpose he may be able to devote it to. * *

"If the subject of insurance was the earnings and income of the elevator, then it was affected by the agreement in question. There was under that construction a change effected in their ownership, or in the interest of the assured and a consequent breach of warranty. If the subject of insurance was not the earnings nor the income, as the endeavor has been to point out, but the mere continuance of the elevator plant in a state or condition of availability for use and occupation, then it mattered not what was done with the earnings of the business so conducted."

Inasmuch as the insurance was held to be valid, the highest court in the State of New York has virtually held that insurance of use and occupancy is not insurance of earnings or income. And the unhappy phrase "Use and Occupancy," unaccompanied by any explanation in the form as to what it meant, cost the insurers, under valued policies, over $60,000, and the insured were clear gainers by the fire to that extent.

A lower court in New York, in a later case bearing indirectly on the subject of use and occupancy, and referring to the Michael case, used the following language:

"But the profits of the business were quite another risk and not at all covered by the phrase 'use and occupancy.' Perhaps the market value of that interest may be as ascertained by proofs in the absence of agreement, but it clearly does not consist of profits plus fixed charges." (Tannenbaum vs. Freundlich, 81 N. Y. Supp., 292.)

COMMENTING ON THE MICHAEL DECISION,

the learned text writer and counsel who handled the case for the defendants, well says that if the earning power and gross earnings of an elevator are no part of its commercial use, it is difficult to see what is. If an absolute transfer of the total earnings is no change of interest whatsoever in the subject matter of "use and occupancy" insurance, it is difficult to conceive what can be. And the layman, who in his daily practice as an adjuster of losses under use and occupancy policies, not valued, is accustomed, in figuring the value, to allow from 90 to 100 per cent. thereof for net profits, may well ask what elements or items capable of being expressed in dollars and cents really go to make up the value of this mysterious something known as "Use and Occupancy" if earnings or profits are not at all covered by the phrase?

The court seems to have looked upon the words as vague and indefinite and in order to avoid a forfeiture apparently chose to regard it as a collective term not subject to analysis or too minute inquiry into the various elements going to make up the value of the entire subject matter. The decision may have been warranted and in the strictest sense, may have been legally sound, but it was inequitable, like many another—based on that convenient apology "ambiguity,"—and if at some future time under different conditions the learned tribunal which gave expression to the foregoing opinion is called upon to decide just what is to be taken into consideration in arriving at the value of the use and occupancy of a plant, the insurance fraternity will be greatly interested in learning what it has to say on this subject.

USE AND OCCUPANCY INSURANCE

is written covering against loss caused by either fire, lightning, windstorm or sprinkler leakage, the most common being fire and lightning. There has been a feeling, which still exists in some quarters, that this class of insurance tends to increase the moral hazard, but probably on account of the discriminating care on the part of companies in selecting their risks, the record thus far has failed to justify these fears. This class of insurance

CANNOT BE WRITTEN INDISCRIMINATELY;

in fact, it would be against public policy for it to become universal. It cannot with safety be granted to any individuals, firms or corporations except those of the highest standing doing a profitable business, and it calls for the utmost good faith on the part of the contracting parties.

In a distant city some time ago, a comparatively small fire occurred in the assembling department of a large manufacturing plant which consisted of sixteen buildings. This department was the one which of all others, could be shut down and discommode the insured the least, and on the basis of the payroll, it constituted as a factor in production a little over five per cent. of the plant.

The adjusters figured the actual use and occupancy loss at less than $1,000, but claim was presented for $27,000, or $9,000 per day for three days, just as if the entire plant had been thrown out of commission; and in addition to this, $9,000 for profit on stock which had been destroyed, making a total claim of $36,000, which modest figure was subsequently raised by the filing of amended proofs for $61,000.

The form provided that if any of the buildings or the contents thereof should be so damaged, destroyed or disabled as to entirely prevent the insured from producing "finished goods," the companies should be liable per day for each working day of such prevention, for an amount not exceeding the net average daily yield of the plant for three hundred working days immediately preceding the fire. It also contained the usual provision in regard to partial prevention. It did not, however, contain any element of co-insurance and the insurance actually carried amounted to only thirty-five per cent. of the annual net profits.

The insured contended, not that they were entirely prevented from carrying on their business of manufacture, but that they were entirely prevented from producing "finished goods"—as if the production of finished goods did not require the use of the entire plant, but only the finishing department. During these three days they were producing finished engines, finished transmissions, finished bodies, and all such parts, but in the opinion of the insured's counsel, all this counted for naught, because they were in the business of producing finished automobiles.

The claim was finally compromised for $10,000, but if the word "finished" can, in a given case engross the attention of three firms of attorneys, consume several thousand dollars in expenses, and protract the adjustment of a three days' partial loss for fifteen months, it would surely seem as if it were a good one to eliminate from the use and occupancy form.

In Order to Determine the Amount

of insurance to be carried, a conservative manufacturer ought to take the net profits for the preceding year, add a certain percentage for expected increase, if any, during the coming year, and an additional amount to cover fixed charges which cannot be dispensed with, for the period of total or partial prevention.

In probably no branch of the business is there a greater variety of forms than that which deals with Use and Occupancy insurance. The regular printed forms of no two companies and no two brokers read exactly alike, and each has special forms to meet the real or imaginary requirements of particular risks. But notwithstanding this lack of uniformity, virtually all contracts of this nature have some points in common.

All policies of this class contain some limitation as to liability. These limitations assume different forms, and among those most frequently used may be mentioned the following:

> One three-hundredth of the amount of the policy for each day of total prevention;
>
> Such proportion of the actual loss of net earnings that the amount of the policy bears to the net earnings for three hundred working days of twenty-four hours each, immediately preceding the fire;
>
> A stated amount per day for each day of total prevention, said limit usually being one three-hundredth of the amount of the policy on the theory that three hundred working days constitute the average working year;
>
> A stated amount for each working day of each particular month, for instance, $60 per day in the month of December and $40 per day in the month of January,—this form being used in connection with certain classes of risks where the working season is limited to six or seven months, as in cotton seed oil mills.

Provision Is Also Made for Ratable Liability in event of partial prevention, and it is right at this point that the ingenuity of the underwriter comes into play in his effort to construct a form which will be clear and concise, and fair both to the insured and the company. And if anyone thinks it is an easy task to prepare such a form, which will be free from criticism, and at the same time retain the good features of the existing forms, he can soon be disillusioned by making the attempt.

Many of these forms are, and all of them should be, modified by prefixing the words "not exceeding" to the above limits, the purpose being to prevent over-payment in event of any material falling off in business activity. Some doubt, however, has been expressed as to whether even these words are sufficient to eliminate the valued feature. When the insurance is valued, special care should be taken to guard against over-insurance.

In writing this class of insurance the permits and limitations usual to regular fire insurance policies (vacancy and non-occupancy permits excepted) are ordinarily included in the form.

Use and Occupancy insurance is not ordinarily written with a co-insurance or reduced rate average clause, but in some contracts the element of full insurance, in one form or another, like the traveling salesman's suit of clothes and the protective tariff, is there all the same.

THE DIFFERENT CONTRACTS IN USE

are so numerous that it will be possible to consider only a few selected at random.

The following is a fair sample of one class of forms quite generally used:

$.............................On the use and occupancy of.................................
...............located at...

It is agreed that if by reason of fire on the above mentioned premises, the assured shall be wholly prevented from producing finished goods, then this company shall be liable for an amount not exceeding $.......................... per day for each working day from date of said fire to date (whether the same fall within the term of this policy or not) when production of such goods might, with reasonable diligence, have been recommenced. But if the normal production be diminished only, then shall this company be liable for that proportion of said per diem in which such production is diminished, it being understood that under no circumstances shall this company be liable in the aggregate for more than the amount of this policy.

In case of stoppage of production by fire, as above specified, the average daily production of the twelve months immediately preceding the fire, shall, for the purpose of this policy, be assumed to be the normal daily production.

In the first place, the words "producing finished goods" should be amended by eliminating the word "finished," if for no other reason than that set forth in the incident to which reference has been made.

It will be noticed that for total prevention, the limit of liability is fixed at not exceeding a certain amount per day, but no provision is made for ascertaining the actual loss per day. The reference to the normal daily production has to do only with the basis of settlement for partial prevention. If therefore, for some time previous to the fire, the plant had been producing much less than its normal output, the question which naturally presents itself is, what would be the per diem loss under the policy for total prevention? Would settlement be based on the output at the time of the fire, the average daily production for the preceding twelve months, or the maximum capacity of the plant irrespective of the actual record previous to or at the time of the fire? I am inclined to think that in the absence of a provision to the contrary, the insured could enforce a claim on the basis of the real capacity, whatever that might be, under the conditions then prevailing up to the per diem limit, the same as he could collect full rental value, whatever that might be, up to the limit under a rental value policy.

According to this view the words "not exceeding" would lose much of their force, but conditions might arise where this limiting provision would be very important. It might, more-

over, be possible for the insurer to prove that under the conditions prevailing, neither the maximum nor the average capacity could have been maintained even if the fire had not occurred and that this might affect the value of the use and occupancy.

If, at the time of the fire, the plant should be running at a capacity much in excess of normal, it is easily conceivable that a severe fire might reduce the capacity considerable, but not below normal, in which event there could be no claim under such a form. And conversely, if at the time of the fire the output should be much less than normal, the insured might be correspondingly benefited. It follows, of course, that a form which is capable of producing these results, is not free from criticism.

It has, however, several points in its favor. It has a limit of liability in event of total prevention; it affords an absolute basis for settlement in case of partial prevention, and provided the per diem limit is not exceeding 1/300 of the amount of the policy, and not less than the normal average yield for the preceding twelve months, it saves to the company the element of full insurance and the advantages to be derived therefrom, which is something that both parties to the contract doubtless have in contemplation when the policy is written. This form, notwithstanding its defects, is quite as fair to the insured as it is to the company, for the former knows at all times how the business is running and can regulate his insurance accordingly, while the latter knows nothing until after a loss has occurred.

The following form, from which I have eliminated the word "finished," is in use by a prominent company:

$..............................On the use and occupancy of....................................
..............................Manufacturing Buildings situate at....................................
and known as..

The conditions of this contract of insurance are, that if any of the buildings used for manufacturing purposes, or machinery therein, shall be so disabled by fire occurring during the term and under the conditions of this policy, that the assured are entirely prevented from producing goods, then this Company shall be liable for an amount not exceeding .... dollars per day for each working day of such prevention; and in case said buildings, or machinery therein, are so disabled by fire as to partially prevent the production of goods, this Company shall be liable per day for not exceeding that proportion of ....dollars which the product so prevented from being made bears to the average daily yield previous to the fire, which for the purposes of this insurance is agreed to be the full daily average for..working days immediately preceding the fire, not exceeding in either case the amount insured.

It Will Be Noticed

that there is practically no difference between this form and the one first considered in regard to total prevention, but there is quite a radical difference in respect of partial prevention. The first makes the "normal production" the absolute basis of settlement in event of partial cessation. The second form

does not make the "normal production" or the "average daily yield" the absolute basis of settlement, but simply utilizes the average daily yield previous to the fire as one element in determining the proportion of the per diem limit in event of partial prevention.

Under the first form, the ——— "normal production," i. e., the average daily production of the twelve months immediately preceding the fire, would be the basis, and if, as has been pointed out, the actual production after the fire equals or exceeds the "normal production," there would be no diminution of the agreed production, even though there may be quite a diminution in the actual production as the result of the fire.

Under the second form, the actual productive power at time of the fire would be the basis, and the partial prevention percentage would be determined by the relative conditions which prevail at the time of and after the fire, taken in connection with the average daily yield prior to the fire. This may not be quite so easy of ascertainment, but the settlement will be fair to the insured in each and every instance. It is easily conceivable that under this form, a claimant might under certain conditions be able to collect the full per diem limit in case of partial prevention. This might happen in event of a partial shut down as the result of a very severe fire when the plant was running greatly in excess of its average capacity, for the figures might show a partial prevention equal to or in excess of the previous average daily yield, and this would, of course, call for the payment of the full per diem limit. This, however, is the natural sequence in all cases of under insurance, in the absence of co-insurance or average conditions.

On the other hand, in event of business depression, resulting in production falling below the average for the preceding year or agreed period, the amount collectible under the second form might be less than that collectible under the first.

It is quite apparent that in this latter form, the element of full insurance, which is supposed to be embodied in use and occupancy policies, is lost to the company by reason of the condition relating to partial prevention and the insured in many instances may be correspondingly benefited.

This form might possibly be improved in thought, if not in diction, by changing the phraseology so as to make it read:

> "This Company shall be liable per day for no greater proportion of not exceeding..............................dollars than the product so prevented from being made bears to the average daily yield previous to the fire."

As it now reads, the limit for total prevention is "not exceeding .... dollars per day"—while the basis for partial prevention is a certain proportion of an absolute fixed amount.

Another Form In Common Use provides that the company shall be liable for such proportion of the actual loss of net earnings ensuing from the use and occupancy of the premises as the amount insured bears to the total yearly net earnings based upon the daily average net earnings immediately preceding the fire. It also provides for the ascertainment of net earnings by deducting all manufacturing expenses from the total sales.

All the forms of this nature which have come to my attention are ambiguous in expression, but the intent is evident. This is the narrowest form of use and occupancy insurance, in that it embraces only one element, to wit, net profits. It has, however, the merit of including in its provisions the principle of the one hundred per cent. average clause, and if the cover were broadened—as it might easily be—and the phraseology improved, it would make one of the fairest conceivable forms both to the insurer and the insured.

The name "Use and Occupancy" is not a particularly happy one, and many attempts have been made to find a more satisfactory term to express the idea. The latest suggestion is "Business Interruption Indemnity" and a prominent company has evolved a form from which the following paragraphs are taken:

"It is understood and agreed that the term 'use and occupancy,' as herein used, shall be construed to mean net profits; general maintenance, to the extent of taxes, heating and lighting; and legal liability of assured for royalties and salaries and wages of employees under contract, as follows:..And if by fire occurring during the period of time named herein, the ability to produce the full daily average of goods be impaired, but not destroyed, then shall this company be liable per day for said actual loss sustained, in such proportion of a sum not exceeding $.. as the product so prevented from being made bears to the full daily average product, it being understood and agreed that for the purpose of this insurance the average daily product for the twelve months next preceding date of fire will be considered the full daily average product."

The idea of explaining in the form just what is meant by use and occupancy, and taking net profits as a basis and adding thereto various items of continuing expense, is a most excellent one. This may not embrace all the items which certain applicants may desire, but any omissions can be easily supplied.

As under one of the other forms referred to, however, the company might in certain circumstances, be called upon to pay the full per diem limit for partial prevention.

In Adopting a Name for Use and Occupancy Insurance, the originators probably had in mind only the occupancy of the buildings of a manufacturing plant and the use of the machinery and tools therein. Many forms still restrict the insurance to buildings and machinery, while others include stock and still others use the broader term "contents." It has

been suggested that such a form might include the profit on manufactured stock when it provides for indemnity in case the insured is prevented from "carrying on his business" as distinguished from "producing goods," the theory being that the only "use" a manufacturer has for finished goods "in carrying on his business," is to sell them and make a profit thereon. In fact, this is the exact praseology used in connection with insurance on department stores and other non-manufacturing property, the main feature of which is profit on sales. These words should not be used in policies covering manufacturing risks, and profits on manufactured goods should be insured as such.

Raw material and constituent parts which come under the general description of stock are important elements in manufacturing, and the destruction of some ingredient or part might interfere very materially with the entire process, just as effectually as the burning of the picker room of a cotton mill or the power house of any plant; hence, raw stock as a factor in production, is a perfectly legitimate item in connection with this class of insurance.

Although use and occupancy insurance is most frequently written to cover manufacturing risks, yet it is used in connection with department stores, mercantile risks and other property of a non-manufacturing nature. When written on mercantile risks the forms are varied somewhat, the phrase "producing goods" giving way to "transacting their business" and the expression "production of goods" to "gross sales." In other respects, the phraseology is very much the same as that used in connection with manufacturing risks.

The Most Remarkable and Ingenious Form

which has come to my attention has recently made its appearance. It covers the use and occupancy of a department store, mentioning building and contents, and has a tabulated sliding scale agreement fixing the basis of per diem liability for each month in the year, said liability for prevention during each of the respective months (varying as such month may be the first, second, third, etc., up to the twelfth), of total or partial prevention.

It also provides that the policy shall pay such proportion of the per diem limits named, as the amount of the policy bears to a stated amount, say $50,000.00, this being the maximum amount payable even if the period of prevention should be the full twelve months. This feature on its face looks good, but according to the table, if a fire should occur, say on the first day of the busiest month, causing total prevention for one month, the loss to the companies would be about 22%; for two months 37%; for three months 50%, and for six months the insurers might possibly have a loss of 85%. These results are about the same as they would be under an ordinary policy where the insurance carried amounts to from

forty to sixty per cent. of the value; hence, that which at first glance has every appearance of being full insurance, or over insurance, operates practically, under the conditions of the contract, as very pronounced under insurance.

The Question Is Frequently Asked—

what period preceding the fire should be taken as the basis of adjustment in case of partial prevention? Some forms provide for settlement on the basis of the average daily yield for three hundred working days immediately preceding the fire; some on the basis of the average daily yield for the previous six months, and some for the previous three months; some from the time the policy is issued until the date of the fire; some for the corresponding season in the twelve months immediately preceding the fire, and some on the basis of a stated amount.

It might be supposed that the greater the normal or average daily yield for the agreed period preceding the fire, the better it would be for the insured, and conversely, the less the normal or average daily yield, the better it would be for the insurer. Under one class of forms which we have been considering, this conclusion is correct, but under another, just the reverse is true. Therefore, a broker or agent who is desirous of adopting a basis which will be most advantageous to his client, would do well to first consider the form in connection with its relation to partial prevention, for that is where the difference lies.

Several attempts have been made on the part of companies to adopt a standard form or set of forms for use and occupancy insurance, but all efforts in this direction have failed, probably for the same reason that this is apparently impossible of accomplishment in respect of other classes of insurance. In the first place, the peculiar conditions connected with one man's business differ materially from those surrounding the business of another, and different forms are needed to meet their respective requirements; and furthermore, standard forms which might meet the needs of a large majority of use and occupancy insurers much better than the miscellaneous aggregation now in use, would interfere with the ingenuity of the broker, for, as one star differeth from another in glory, so does one broker's form differ from that of his rival in point of desirability, in his own opinion at least, although this opinion is ofttimes subject to revision after a loss has occurred.

Inasmuch as the only courts which have rendered any decisions bearing on the subject of Use and Occupancy insurance, have declared that it does not cover profits nor fixed charges, and one has gone so far as to say that profits, which are always an uncertain element and speculative to a certain extent, do not even form any basis for calculating the market

value of the use and occupancy of a plant (Tannenbaum vs. Simon, 81 N. Y. Supp., 655), it would seem desirable to have the form clearly set forth exactly what is intended to be covered.

The Court of Appeals, in the Michael case, very properly said that the defendant might have avoided all questions of construction if it had plainly stated that the business of the plaintiff, or its earnings or profits, was the subject of insurance instead of using such a vague term as Use and Occupancy. Although the subject has engaged the attention of some of the best minds in the business,

THE IDEAL FORM HAS NOT YET BEEN PREPARED.

Virtually all of those in current use contain some excellent features, and unless there is some material increase or decrease in the business activity of the insured, adjustments made thereunder ought to be reasonably satisfactory to all parties in interest.

The Interest of a Mortgagee under a

Policy of Fire Insurance

A LECTURE

DELIVERED BEFORE

The
Fire Insurance Society
of Philadelphia

March 19th, 1917

BY

W. N. BAMENT
General Adjuster

THE HOME INSURANCE COMPANY
NEW YORK

The Interest of a Mortgagee Under a Policy of Fire Insurance

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When it is considered that fully sixty per cent. of all the real estate in this country is encumbered to a greater or less extent by mortgage, and that the lenders of money thereon almost invariably insist upon having the improvements covered by policies of fire insurance, payable to them as collateral security, it is at once apparent that the subject of this address is one of exceedingly great interest to the vast number of corporations and individuals who loan money on real estate and of scarcely less interest to the underwriters who issue policies thereon.

It has been the aim of insurance companies to meet the peculiar requirements of these mortgagees in respect of insurance, by giving them special forms of contract, exceedingly liberal in their terms; and in so doing they have, in some instances, gone to unreasonable lengths and far beyond what was originally contemplated in protecting said interests. And in the light of the interpretations which have been placed upon the provisions in favor of the mortgagees, it will be perfectly safe to say that if there is a more highly favored party to any contract than a mortgagee under a policy of fire insurance, he has not yet been discovered. Whenever he has asked he has received, whenever he has sought he has found and whenever he has knocked it has been opened unto him either by the insurers themselves or by the courts, for what the former have omitted the latter have supplied.

In Maine, Massachusetts, Mississippi and North Carolina, the mortgagee has, by statute, under certain conditions, a lien against the insurance money due the mortgagor. In Louisiana a clause is used, making loss, if any, payable to the holder or holders of the mortgage notes. In New York City the loss is made payable to the original mortgagee, or the owner of the mortgage at the time of the fire, the former, however, agreeing upon request to inform the insurer of the name and ad-

dress of the party to whom it may have been assigned. In New England the loss is made payable to the mortgagee as his interest may appear under present and all future mortgages covering the premises. In the West the loss is made payable to the mortgagee or his assigns. In Canada the policy is continued in force for the benefit of the mortgagee after expiration, and until the mortgagee or the insurer serves notice of cancellation; the mortgagee, however, being liable for the premium for the extended period. In Mississippi the standard mortgagee clause is written into the policy by operation of law. Sec. 2596 of Code—Bacot vs. Phenix Ins. Co., 96 Miss. 223, 50 So. Rep. 729.

If a mortgage contains an agreement that the mortgagor shall keep the mortgaged property covered by insurance for the benefit of the mortgagee, and for any reason he fails to have the loss made payable to him, the mortgagee has an equitable lien against any insurance that the mortgagor may have, and if the insurer receives notice of such lien before making payment he will ignore it at his peril. Wheeler vs. Insurance Co., 101 U. S. 439; Aetna Ins. Co. vs. Thompson, 68 N. H. 20, 40 Atl. 396; Swearingen vs. Hartford Fire Ins. Co., 52 S. C. 309, 29 S. E. 722, 56 S. C. 355, 34 S. E. 449.

In several states it has been held that the short form "loss payable" clause is nothing more or less than an unconditional agreement to pay the mortgagee in event of loss, and if there are any privileges and advantages he does not possess, it is either because he has not yet thought of them or has not demanded them. And more remarkable still is the fact that for all this the mortgagee pays nothing whatever. He gets without money and without price a contract which the mortgagor or owner of the best risk in the land cannot buy at any price.

The mortgagee, however, is entitled to absolute protection from acts and conditions outside his knowledge and beyond his control, and if the insurer is willing to grant this protection without extra premium, no criticism can attach to the mortgagee if he gracefully accepts the benefits thus generously bestowed. In fact, the writer entertains the hope, perhaps a forlorn one, that some time he himself may emerge from his normal condition of mortgagor and become a member of the mortgagee class with its attendant benefits.

In the year 1858 the large insurance companies and other loaning institutions received quite a severe shock and rather a rude awakening by two decisions which were handed down by the Court of Appeals of New York. Prior to that time, by reason of decisions rendered in 1832 and 1851, it had been their custom to accept fire insurance policies as collateral security with the short form clause "Loss, if any, payable to .... mortgagees as their interest may appear," or to have the policies assigned to them for collateral purposes with the consent of the insurers, in the belief that

their interests could not be adversely affected by any act or neglect on the part of the mortgagor or owner.

The decisions referred to are Grosvenor vs. Atlantic Fire Insurance Co. (17 N. Y. 391) and Buffalo Steam Engine Works vs. Sun Mutual Insurance Co. (17 N. Y. 401). The former was a case involving the "loss payable" clause and the latter one involving an assignment of the policy to the mortgagee, the Court in both instances holding that the mortgagee was merely the appointee of the party insured, to receive the money which might become due him from the insurers upon the contract; that the "loss payable" provision in the policy in favor of the mortgagee had no more effect upon the contract than it would if it had provided that the loss for which the insurer should become liable should be deposited in a specified bank to the credit of the party insured. The rule of construction thus adopted by the New York Court was followed in other jurisdictions and naturally spread consternation among the large lenders of money on real estate, because the security, which they had hitherto regarded as absolute, was by these sweeping decisions found to depend upon conditions of which they had no knowledge and over which they had no control. This situation was of course intolerable and it became necessary for mortgagees either to take out special policies of insurance covering their mortgage interests or secure some special form of contract in their favor to attach to the policies of the property owners. The outcome was the adoption of a special mortgagee agreement, substantially the same as the present standard mortgagee clause, which, however, did not come into general use until some years later.

In the year 1886 the New York Standard Fire Insurance Policy was adopted by the legislature of that state, together with a number of permissible riders, among which were three mortgagee agreements, one known as the "New York Standard Mortgagee Clause without Contribution," another the "New York Standard Mortgagee Clause with Full Contribution" and a third the "New York Standard Mortgagee Clause when owner has no interest in the insurance." The first two are exactly the same in phraseology, except that one contains the contribution clause, which reads as follows:

> "In case of any other insurance upon the within described property, this Company shall not be liable under this policy for a greater proportion of any loss or damage sustained than the sum hereby insured bears to the whole amount of insurance on said property, issued to or held by any party or parties having an insurable interest therein, whether as owner, mortgagee or otherwise."

This contribution clause has been the subject of two leading cases of absorbing interest in insurance litigation, to which attention will be directed later.

Two of these mortgagee clauses provide that the interest of the mortgagee shall not be invalidated by any act or neglect of the mortgagor or owner, nor by foreclosure proceedings,

change of title or ownership, or increase of hazard, provided the mortgagee shall notify the company of such changes or increase in hazard as may come to his knowledge, and pay premium therefor and provided also that the mortgagee shall pay the premium in event of default by the owner; also for cancellation and for subrogation in event of non-liability to the mortgagor or owner.

The third mortgagee clause is intended for use where the policy is issued direct to the mortgagee covering his interest only, and contains a provision for subrogation. This latter clause is seldom used, but if a policy is issued direct to the mortgagee, he is "the insured" and is bound by all the terms and conditions of the policy.

The New York Standard Policy and its collateral agreements have been formally adopted by a number of other states either verbatim or with slight modifications, while others have adopted standard forms differing materially therefrom, but it is safe to say that in all the United States, aside from those which have standard policies of their own, fully seventy-five per cent. of the policies issued are the New York Standard. It would seem that this approach to uniformity in contract should be attended with something approaching uniformity in court decisions, but such is not the case, because the courts of the various states differ with each other on many points and the federal courts have differed radically with the New York Court of Appeals in the interpretation of several very important conditions, one of which bears directly upon the interest of the mortgagee.

The storm center of most of the litigation which has taken place in connection with the interest of the mortgagee is to be found in lines 56 to 59 of the policy, which read as follows:

> "If, with the consent of this company, an interest under this policy shall exist in favor of a mortgagee or of any person or corporation having an interest in the subject of insurance other than the interest of the insured as described herein, the conditions hereinbefore contained shall apply in the manner expressed in such provisions and conditions of insurance relating to such interest as shall be written upon, attached or appended hereto."

This paragraph has been to some courts a stumbling block and to others foolishness, and if it were not in the policy, or if the intention of its authors had been more clearly expressed, much of the litigation which has taken place would have been avoided.

There are three leading cases involving the question of contribution under the mortgagee clause, two by the New York Court of Appeals and one by the United States Circuit Court of Appeals.

The first is that of Hastings vs. Westchester (73 N. Y. 141) decided by the New York court in 1878. One policy, the Westchester, was issued to the owner with loss payable

to the mortgagee; the other, the Lycoming, was issued to the insured with loss payable to himself. The mortgagee clause itself did not contain any provision for contribution, and the company relied upon the contribution clause in the printed conditions of the policy. Suit was brought against the Westchester by the mortgagee, who claimed the full amount of loss from that company. The court held that by reason of the mortgagee clause, the policy operated as an independent insurance of the mortgagee's interest and that the Westchester was liable for the full amount of the loss, but was entitled to subrogation, for what it might be worth, to the extent of the excess which it was compelled to pay over and above its pro rata liability to the insured. Whether the Westchester, by reason of its subrogation rights, could, for its indemnity, have any recourse against the proceeds of the policy in the Lycoming Insurance Company was a question which the court did not feel called upon to decide, and no court has attempted to do so since. The question did not come up again for sixteen years, but in the same month of the same year, to wit: October, 1894, the New York Court of Appeals decided the case of Eddy vs. London Assurance Corporation et al. (143 N. Y. 311) and the United States Circuit Court of Appeals rendered its decision in the case of Williams, Trustee, vs. Hartford Fire Insurance Co. (63 Fed. 925), both involving the question of contribution under the mortgagee clause.

It will be remembered that in the case of Hastings vs. Westchester the mortgagee agreement did not contain the contribution clause. In the Eddy case some policies contained the mortgagee clause with full contribution and some contained the clause without contribution, while others were payable direct to the insured. In the Williams case the policy contained the mortgagee clause with full contribution so that, with respect to the clause with full contribution, the two cases were on all fours with each other, yet these two courts of last resort reached diametrically opposite conclusions, neither knowing the views of the other.

The lines of reasoning adopted by these eminent tribunals in reaching their respective decisions will be found interesting. The New York Court said that the words "the interest of the mortgagee shall not be invalidated" should not be given a narrow, but on the contrary, a broad interpretation, and meant that the interest of the mortgagee should not be injuriously impaired or affected by the act or neglect of the owner; that in order to constitute double insurance, the policies must cover the same interest in the same property or some part thereof; that although the contribution provision was inserted as a part of the mortgagee clause, and called for contribution from the whole insurance on the property held by any party or parties having an insurable interest therein, whether as owner, mortgagee or otherwise, this

provision was inconsistent with the primary promise that the interest of the mortgagee should not be impaired by the act or neglect of the owner and that the primary promise must prevail. The court admitted that this view might not give full effect to the strict language of the contribution clause, but held that taking the contract as a whole, it was unreasonable to suppose that the parties intended to permit the interest of the mortgagee to be adversely affected by the secret act of a third party, and that the contribution clause must be limited in its operations to the insurance held by or consented to by the mortgagee.

The Federal Court, in its decision, said that the particular language employed in the mortgagee clause respecting contribution, seems to have been inserted for the express purpose of making it clear that the mortgagee's policy was entitled to pro rate with all policies covering the property which at the time of the loss might be held by any person whomsoever had an insurable interest in the property. In the absence of the words "issued to or held by any party or parties having an insurable interest therein," it might no doubt be fairly argued that it was simply the intention of the parties to reserve the right to pro rate with other policies procured by the mortgagee for the protection of his interest, but the use of the words quoted rendered that construction inadmissible. Those words appear to have been added out of abundant caution that there might not be any room for doubt on the subject. The court further said that it would not be justified in ignoring an agreement in one part of the instrument, which is as clearly expressed as language could well express it, merely because it limits to some extent the scope of general language employed in another part of the instrument. It further surmised what is undoubtedly true, that the contribution clause was phrased precisely as it is, and inserted as a part of the mortgagee clause itself for the purpose of remedying the defect brought out in the case of Hastings vs. Westchester, and for the sole purpose of securing the contribution which was denied in that case.

Two courts of such prominence having differed with each other, the question which naturally presents itself is, which is the better law? Although the mortgagee should have absolute protection in the matter of his insurance, unaffected by the acts of omission or commission on the part of third persons, and while it is true that under the interpretation placed upon the contribution clause by the Federal Court, his interest might in certain circumstances be very materially impaired, yet, to use a favorite expression of the judiciary, it is the province of the courts to construe contracts, not to make them, but it seems that the New York Court of Appeals in the Eddy case went out of its way to amend the existing contract by virtually eliminating therefrom the words "issued to any party or parties having an

insurable interest therein." There is no ambiguity, no language could be plainer and it is impossible to conceive of any object that the parties could have had in using those words other than to avoid the very construction of the clause which the Court of Appeals adopted.

The Federal decision was legally sound, but the contribution provision contained in the standard mortgagee clause is not fair to the mortgagee, and it should be amended so as to permit contribution from those policies only, which are payable to, held by or consented to by the mortgagee; for otherwise he will not, in many instances, have the security to which he is justly entitled.

A short time after the standard policy went into general use, the insurance companies and the framers thereof received about as great a shock as the mortgagees had received years before, the occasion being a remarkable decision rendered by the Supreme Court of Nebraska in the case of Oakland Home Ins. Co. vs. Bank of Commerce (47 Neb. 717), in which it was held that under the short form "loss payable" clause, the mortgagee is not bound by any of the conditions of the policy whatsoever. According to the interpretation placed by the court upon lines 56 to 59, if the company desired any of the policy conditions to apply to the interest of the mortgagee, it would be necessary for those conditions to be specially written upon, attached or appended to the rider, and inasmuch as no conditions were so appended, or included in the "loss payable" clause, the mortgagee virtually possessed an unconditional contract, and in the absence of fraud on his part the company had no alternative but to pay the loss. The court commenting upon lines 56 to 59 used the following language:

> "And even if there be doubt as to the correctness of this construction, there is some satisfaction in the fact that an insurer who puts such a nondescript provision into his policy should hardly be heard to object to any kind of construction which any one chooses to give it."

Six other states, to wit: Mississippi, Iowa, Washington, Missouri, California and Ohio have rendered similar decisions. Several judges dissented and Mr. Freeman, the learned annotater, says that these cases go to the extreme, if not questionable, limit, in upholding the rights of the mortgagee, where there is no clause in the policy securing the mortgagee against any act or neglect of the mortgagor—East vs. New Orleans Ins. Assn. 76 Miss. 697, 26 So. Rep. 691; Christenson vs. Fidelity Ins. Co. 117 Iowa 77, 90 N. W. 495, 94 Am. St. Rep. 286; Boyd vs. Thuringia Ins. Co. 25 Wash. 447, 65 Pac. 785, 55 L. R. A. 165; Senor et al. vs. Western Millers Mut. F. Ins. Co. 181 Mo. 104, 79 S. W. 685, 33 Ins. Law Journal 455; Welch vs. British America Assur. Co. (Cal.) 82 Pac. 964; Farmers Natl. Bank vs. Delaware Ins. Co. (Ohio) 83 O. S. 309, 40 Ins. Law Journal 1248.

According to these decisions it is quite evident that in those particular states the short "loss payable" clause is much more favorable to the mortgagee than the standard mortgagee clause itself, for the latter does reserve some few rights to the insurer, while the former reserves none.

Various suggestions have been made as to how the "loss payable" clause should be amended so as to meet the conditions brought about by these decisions, and in this connection it is important to note that in none of the cases referred to did the clause contain any reference to the conditions of the policy.

The following has been suggested: "Loss, if any, payable to..................................mortgagee, as interest may appear, subject, nevertheless, to all the conditions of this policy," but this has been objected to on the ground that on its very face it creates a distinct contract with the payee, which it is desirable to avoid, and the answer to this criticism is that the several courts, whose opinions we have been considering, have practically decided that lines 56 to 59 of the policy have that effect as soon as a "loss payable clause" is placed on the policy. And, although a mortgagee under the "loss payable" clause is not an "insured," yet the New York Court of Appeals has ruled that he is bound by all the policy conditions prior to line 56, but is not bound by those after line 60. MacDowell vs. St. Paul F. & M. Ins. Co., 207 N. Y. 472. And all courts without exception which have passed on the question (and they are numerous) have held that the mortgagee, payee, is entitled to notice of cancellation.

Another objection is that by making the policy subject to *all* the conditions of the policy, we simply reaffirm lines 56 to 59, which brings us back to where we started from. It is possible, however, that under the form suggested the courts might, notwithstanding, render their decisions in accordance with the manifest intention of the parties.

Another suggestion is:

"Any loss which may be ascertained to be due the assured under this policy, shall be held payable to..................................as interest may appear. It being understood and agreed that there is no contract under this clause or policy with.......................................except as relating to the payment of money due the assured..."

And still another is:

"Loss, if any, payable to..................................as interest may appear. This endorsement shall be held to vest in said payee no right or interest in this insurance save as the appointee to receive the amount, if any, which may become due the assured hereunder, in the event of loss, any condition of the policy to the contrary notwithstanding."

The latest suggestion is as follows:

"It is hereby agreed that such loss or damage as shall have been ascertained and proved to be due under all the conditions of the within policy to.......................................(which conditions are hereby by reference incorporated into, and made applicable to the payee herein named as a part of this agreement as fully as though written at length herein), shall be held payable unto.."

But no simple "loss payable" clause has as yet been devised which can secure universal endorsement and at the same time meet the requirements of lines 56 to 59 of the standard policy as interpreted by many of the courts.

The State of California has solved the difficulty in its standard policy by leaving out the paragraph contained in lines 56 to 59 and this is probably the simplest and most effectual way of remedying the defect. It has also been left out of the new standard policies recently adopted by the states of Pennsylvania, North Carolina and South Carolina. This, of course, could not be done except in non-standard policy states.

In striking contrast to the foregoing decisions may be mentioned the case of the Atlas Reduction Co. vs. New Zealand Insurance Co., decided by the United States Circuit Court of Appeals, Eighth Circuit, April 24, 1905. The policy covered both the realty and personalty and contained the following clause: "Subject to all the conditions of this policy, loss, if any, payable to G. B. Dodge and A. M. Stevenson, as their interest may appear," two mortgages, one of the realty and the other of the chattels having been executed by the Reduction Company. It was held that the endorsement is a common method of furnishing security to a creditor, but does not make a new contract with the payee, or waive any policy condition; that the payees were the simple appointees of insured to receive any payment that might be due to the extent of this interest; that the endorsement did not give consent to a chattel mortgage to D. and S. contrary to a provision in the policy that it should be void in case of such mortgage; that oral testimony was not admissible to show that the agent intended the endorsement as a consent to such mortgage; that where the entire policy, by its terms, was void in case of such mortgage, there could be no recovery. (Vol. 34, Ins. Law Journal, page 805.)

It will be noticed that the clause in this case contained the words "subject to all the conditions of the policy," whereas in the other cases referred to they were omitted. The prevailing opinion of Justice Van Devanter and the dissenting opinion of Justice Hook, with the authorities cited, are well worth a careful study.

One of the most interesting questions connected with this subject is whether a mortgagee under the mortgagee clause is bound by the conditions of the average or co-insurance clause. If he is, the adverse result to the insurers on account of their inability to apply the contribution clause to the mortgagee's interest, would, by reason of the general use of average or co-insurance conditions, be in a large measure neutralized.

One leading authority has expressed the opinion that the interest of the mortgagee cannot be affected by a co-insurance clause unless it is made to appear in clear and explicit terms

that the mortgagee agrees to be bound by the provisions of the clause as a part of his contract with the company. While apparently admitting that it is a close question, this authority is led to the above conclusion partly on account of the attitude of the Court of Appeals in the case of Farmers Feed Co. vs. Scottish Union and National Insurance Co. (173 N. Y. 241). It is not contended that the questions are on all fours with each other, but in view of the trend of the judicial mind as set forth in the Farmers Feed Company and other cases it is thought that the court would treat the interest of the mortgagee under the mortgagee clause as free from co-insurance limitations.

Another eminent authority has expressed the opinion that the mortgagee would not be bound by the co-insurance clause as applied to the value of the property, and if applicable at all it would apply only to the value of the mortgagee's interest, just as the co-insurance clause, under an excess floating policy in practice is made to apply only to the excess value and under a rent policy or use and occupancy policy to the value of the interest insured; in short, that the words "value of property" would be construed to mean "value of interest."

According to still another authority, we are not warranted in assuming or admitting that the mortgagee is exempt from co-insurance conditions as applied to the value of the property. He says that the short payee clause by itself has been passed upon many times by the courts and for over fifty years it has been universally held in New York, and many other states, that under such a clause, although it may contain the phrase "as interest may appear," the mortgagee can recover only what the mortgagor would be entitled to "under the policy." This payee clause does not purport to define the amount payable to a mortgagee other than by reference to the policy itself and further to declare that it shall not exceed the amount of the mortgagee's interest. The mortgagee clause gives the plainest sort of notice that it is only "loss under the policy," that is to say, loss subject to the terms and provisions of the policy, that is payable to the mortgagee, with the single exception that certain classes of forfeiture are not to be exacted as against the mortgagee.

Recent decisions by the highest Courts in New York and New Jersey hold that the mortgagee is not bound by those conditions of the policy affecting the situation after a loss (lines 50 to 112), but imply that he is bound by the antecedent conditions (lines 1 to 55) except as modified by the mortgagee clause. The average or co-insurance clause, however, is a part of the contract and when the mortgagee accepts the policy with such a clause therein, it is his own voluntary act. He should be as much bound by it as by the amount of the policy, date of expiration and description of the property. This imposes no hardship upon him; his interests are not placed at the mercy of third parties and the arguments which have

been advanced against the operation of the contribution clause do not apply. He can insist upon insurance payable to himself being taken out equal to the stated percentage of the value of the property and thereby secure absolute protection, and it is the rule with certain large loaning institutions to insist upon this in order to meet the necessities of each case, unless they regard their security as ample without it. One exception, however, should be noted. If extraordinary improvements and repairs are made to the building after a policy is issued, without the knowledge of the mortgagee, thereby materially increasing the value of the property, this would be an act of the owner by which the mortgagee would not be bound.

We have here three different views on this subject expressed by high legal and lay authorities, but in July, 1915, the Appellate Division, Second Department of the Supreme Court of New York in the case of Hartwig vs. American Insurance Co. of Newark, 46 Ins. Law Journal 455 handed down a unanimous decision holding that the average or co-insurance limit of liability is binding on the mortgagee and used many of the arguments advanced in the view last expressed. The court held that the mortgagee clause does not contain the whole contract made with the mortgagee; that the amount of insurance agreed to be paid by the insurer is not a condition, but an integral part, of the policy, limiting its liability, as to any one, to the proportion of the loss it undertakes and agrees to pay. It further held that the legal effect of the standard average clause is to make the liability of the insurer the same as if the words in the policy "to an amount not exceeding $1500.00," together with the 80 per cent. average clause, had been omitted from the policy, and in lieu thereof had been written the words "to an amount not exceeding the sum of $1500.00 if such direct loss or damage equals 80 per cent. of the actual cash value of the property insured at the time such loss shall happen, and, if not, such proportion of any loss or damage to the property described herein as such sum of $1500.00 bears to 80 per cent. of the actual cash value of said property at the time of such loss." The case has been appealed and the decision of the Court of Appeals is now awaited.

In the City of New York, probably on account of the decision in the Eddy case, (supra), the use of the mortgagee clause with full contribution seems to have fallen into disuse and to have been superseded by the clause without contribution. The question, therefore, arises whether in the state of New York, in view of the decision of the Court of Appeals, the contribution clause possesses any virtue whatever and whether, as a practical proposition, it makes any difference which of the two clauses is used. Seventy-five years ago the contribution provision now contained in the printed conditions of all fire insurance policies, had not come into general

use, and in event of partial loss, a claimant could, if he desired, collect the entire amount of his loss from any one of his insurers, not exceeding, of course, the amount of its policy, and that company would look to the other companies for their pro rata proportion of the claim. We have seen that in the Hastings case the mortgagee is not bound by the contribution clause in the policy and in the Eddy case that the contribution clause in mortgagee agreement applies only to policies payable to the mortgagee or consented to by him. In the Heilbrunn case, we find that the contract, so far as the mortgagee is concerned, stops at line 59 and that the succeeding conditions, among which the contribution clause appears, is not binding upon him. If, therefore, there is no contribution provision in the mortgagee clause and the mortgagee should desire to collect the entire amount of his loss from any one of his insurers, there would seem to be nothing to prevent his doing so, although he would hardly care to exercise this right unless some of his insurers should, by reason of a severe conflagration or otherwise, become insolvent. This is a somewhat remote contingency, although large conflagrations are occurring with too great frequency and it is simply mentioned as one of the possibilities under the mortgagee clause which does not contain the contribution provision.

That the interest of the mortgagee is quite a live question is evidenced by the fact that the September, 1911, issue of the "Insurance Law Journal" reported three cases and the October issue one case, touching various phases of the subject, but by far the most interesting, most important and most disappointing was that of Heilbrunn vs. German Alliance Insurance Co., decided by the New York Court of Appeals, to which reference has been made, affirming the majority opinion of the Appellate Division, 202 N. Y. 610, 95, N. E. 823. The court decided that the mortgagee's interest is not affected by any of the policy conditions following line 59, which relate to conditions after a fire, and as most of the conditions preceding line 59 are either modified or nullified by the mortgagee clause, he comes pretty close to having a conditionless contract. It follows from this that in the state of New York a mortgagee is under no obligation to give the company any notice of loss, nor furnish proof of loss, nor submit to appraisal or examination of any kind. He is not bound by the conditions of the contribution clause and can bring suit at any time within the statutory limit of six years. The Court admitted that insurance companies ought to have more protection in the matter of time within which actions upon their policies must be brought and possibly in other respects, but that relief must come, if at all, from the legislature through modification of the standard policy. The dissenting opinion of Justice McLaughlin in the Appellate Division is a masterly

effort and presents the most rational construction of the standard policy that has yet appeared. The Supreme Court of Ohio, in the case of Erie Brewing Co. vs. Ohio Farmers Insurance Co. (Ohio, 1909), 89 N. E. 1065, Vol. 39 Ins. Law Journal 200, rendered an opinion similar to that of Justice McLaughlin, and swung the pendulum so far in the other direction as to hold that the mortgagee under the mortgagee clause was bound by an award of appraisers to which he was not a party and of which he had no notice.

The Court of Appeals in its decision in the Heilbrunn case (supra) said:

> "But the difficulty is that the language of those stipulations or conditions of the policy which relate to the proceedings after the liability of the company has accrued through the fire, does not enable us to apply them to the mortgagee in such part only as may be practical or expedient. We must hold (unless our decision be wholly arbitrary) that all those stipulations which in terms relate to the mortgagor only, apply equally to the mortgagor and mortgagee, or we must hold that none of them do. The former dictates that which is impossible and the order of the Appellate Division in this case should therefore be affirmed."

After reading this decision in connection with that of the Appellate Division which it affirms, and the strong dissenting opinion of Justice McLaughlin, one cannot help wondering whether, if the interests of the mortgagee rather than those of the insurance company had been adversely affected, the situation might not in some manner have been saved from the realm of the impossible. The Court in the Eddy case experienced no difficulty whatever in actually striking out of the contribution clause a certain inconvenient phrase which was as plain as language could make it on the ground that the only meaning which could reasonably be given it could not possibly have been intended. That the legislature intended, for obvious reasons to grant to the mortgagee a somewhat more liberal contract than to the property owner, cannot be doubted, but that it for one moment intended when it adopted a standard statutory form of policy which the title to the act shows was established as a "uniform policy" for all parties, to single out this one class, to wit: mortgagees, and exempt them from all the usual obligations which all other insured citizens must observe, is inconceivable.

Line 58 indicates very clearly that it is only "the conditions hereinbefore contained," that can be modified by the mortgagee clause or rider, and the Supreme Court of Ohio in its well considered opinion (supra) says:

> "It would appear reasonable that in respects not modified or limited by the express language of the mortgagee clause, the plain provisions of the policy must prevail and be observed."

This is a reasonable interpretation of the contract even if no consideration be given to the intention of the legislature, but in New York the court of last resort has spoken and the law in that state has therefore been determined. In the Eddy

case the Court found it possible to arbitrarily decide contrary to the manifest intention; in the Heilbrunn case it found it impossible to arbitrarily decide according to the undoubted intention.

After rendering the sound decision to which reference has been made, the personnel of the Supreme Court of Ohio underwent a change and in a very crude and ill-advised opinion, held that the mortgagee, could recover, even though the policy might be void as to the mortgagor, and this too under the ordinary "loss payable" clause. Farmers National Bank vs. Delaware Insurance Co. (83 O. S. 309), 40 Ins. Law Journal 1248. This is the seventh state which has placed this interpretation upon lines 56 to 59.

It has been seen that under the forms of policy in use prior to the adoption of the New York Standard, the plain "loss payable" provision, in the absence of the mortgagee clause, did not import an agreement to pay the mortgagee independent of that to pay the "insured" or the mortgagor; that is, if the policy had been rendered void as to the mortgagor or owner, it became void as to the mortgagee also. The rule is the same in the case of the standard form, Moore vs. Hanover Fire Ins. Co., 141 N. Y. 219, 36 N. E. 191, but, the words "first payable" and "as his interest may appear" import that the interest of the mortgagee is greater than the interest of a mere naked appointee, Pitney vs. Glens Falls Ins. Co., 65 N. Y. 6. He would be a necessary party to an action on the policy brought by the mortgagor. Lewis vs. Guardian Fire & Life Assurance Co., 181 N. Y. 392, 74 N. E. 224, 106 Am. St. Rep. 557. He is not bound by a settlement of a claim to which he has not assented. Hathaway vs. Orient Ins. Co., 134 N. Y. 409, 32 N. E. 40, 17 L. R. A. 514.

The rights of the mortgagee under the plain "loss payable" clause are clearly set forth in the unanimous opinion of the Court of Appeals of New York in the case of McDowell vs. St. Paul F. & M. Ins. Co., 207 N. Y. 482, Vol. 42 Ins. Law Journal 796, where the court decided that the mortgagee is not precluded from recovery of loss incurred because the mortgagor refused to make proof of loss as required. The court said that it was reasonable that those conditions which affect the risk, while it is subsisting, should apply alike to mortgagor and mortgagee, unless the parties have stipulated otherwise by attaching a mortgagee clause, but that it was unreasonable after a loss had occurred, that the interest of the mortgagee should be subject to the caprice of the owner, and that was equally true whether there was a mortgagee clause or merely a "loss payable" endorsement. The natural inference to be drawn from this decision and that of Hathaway vs. Orient Ins. Co. (supra) is that under the "loss payable" clause, as well as under the mortgagee clause, the mortgagee is not bound by any of the policy conditions after line 60.

In Massachusetts the courts, prior to the adoption of the present standard policy, held that in the absence of a subrogation provision in the policy, the mortgagee could collect the amount of loss and also retain the mortgage notes; Kings vs. Ins. Co., Mass., 7 Cushing 1. This is the only state which has so held; the opinion has been severely criticised and other jurisdictions have ruled that even in the absence of an agreement for subrogation the insurer is entitled to an equitable assignment of the debt from the mortgagee.

The Supreme Judicial Court of Massachusetts has decided that under the standard policy of that state, if the title becomes vested in the mortgagee by foreclosure, the policy is void unless the sale is consented to by the insurer. Boston Co-operative Bank vs. American Central Ins. Co., 87 N. E. 594, 38 Ins. Law Journal, 599. It has also held that the mortgagee must file notice and proofs of loss if the owner does not, but he is granted a reasonable time and is not held to such a strict accountability as the insured in the matter of time. Union Institution for Savings vs. Phoenix Ins. Co., 37 Ins. Law Journal, 43.

In Connecticut it has been held that under the short form "loss payable" clause the mortgagee has no right to a voice in the appraisal, while under the mortgagee cause he has. Collinsville Savings Society vs. Boston Insurance Co., 31 Ins. Law Journal, 1031.

The words "act or neglect" used in the mortgagee clause have been held to refer to any act or omission on the part of the mortgagor, whether before or after the issue of the rider or policy, but the decisions on this point are conflicting. On the other hand, it has been held that the clause is effective only as to subsequent acts or neglect of the mortgagor; also that if a condition of the policy has already been violated so as to afford a ground for forfeiture, it cannot be revived by attaching thereto the mortgagee clause unless a new consideration is paid therefor. Misrepresentations of which the mortgagee has knowledge will be attributable to him and he will also be bound by his own misstatements. Generally speaking, the better opinion seems to be that no act or neglect of the mortgagor unknown to the mortgagee, whether prior or subsequent to the date of the contract, will avoid it as to his interest. The latest decision on this point is that of Reed, et al, vs. Firemen's Insurance Co., of New Jersey (Vol. 40 Ins. Law Journal, 1711).

The mortgagee clause gives the mortgagee the right to commence foreclosure proceedings, but makes it incumbent upon him to notify the company of any change in the title or ownership of the property which shall come to his knowledge. It has been held in at least four states (Kansas, Minnesota, Iowa and Rhode Island) that this has reference to a change or transfer of title to a third person and not to one from the mortgagor to the mortgagee by foreclosure. The

argument is that the insurer must have known when attaching the clause that it might be necessary for the mortgagee, in order to protect his interest under the mortgage, to commence foreclosure proceedings; that this would not have a tendency to diminish the interest of the mortgagee in the property, but rather to increase it, and it has been held that an increase in the interest of the insured is no ground for forfeiture of the policy. Pioneer Savings & Loan Co. vs. St. Paul F. & M. Ins. Co., Minn., S. C. 26 Ins. Law Journal 826; Lancashire Ins. Co. vs. Boardman, Kan., S. C. 27 Ins. Law Journal 1898; Bailey vs. American Central Ins. Co. (Iowa), C. C. 13 Fed. Rep. 250; Continental Ins. Co. vs. Wood, 50 Kan. 346, 31 Pac. 1079; Heaton vs. Manhattan Fire Ins. Co., 7 R. I. 502; Esch vs. Home Ins. Co., 78 Iowa 334, 43 N. W. 229, 16 Am. St. Rep. 443; Dodge vs. Hamburg Bremen F. Ins. Co., 4 Kan. App. 415, 46 Pac. 25; Washburn Mill Co. vs. Fire Ass'n, 60 Minn. 170, 61 N. W. 828, 51 Am. St. Rep. 500.

In the case last cited it was held that the subsequent acquisition of the title to the mortgaged property by the mortgagee will not affect the right of the insurance company to the subrogation as stipulated.

On the other hand, if, at the time of the issue of the policy or the attaching of the mortgagee clause, the mortgagee has knowledge of facts which render the policy void as to the insured, it is void also as to the mortgagee, as he is bound by every consideration of good faith to disclose to the insurer the information he possesses. Genessee Savings & Loan Ass'n vs. U. S. Fire Ins. Co., 16 App. Div. 587 N. Y.

If a mortgagee, after a fire, assigns the mortgage, without transferring any interest in the policy or right of action for the loss caused by fire, there can be no recovery by the assignee of the mortgage. Kupfersmith vs. Delaware Ins. Co (N. J.).

If foreclosure proceedings are commenced and before they proceed, so far as a judgment, a fire occurs, the mortgagee has a right to proceed with the foreclosure and to a sale of the premises, and the value of the subrogation rights of the insurance company will depend upon whether or not anything beyond the mortgage debt is realized through the proceedings. Eddy vs. London Assurance Co. (supra).

An assignment of the mortgage accompanied by an assignment of interest in the policy by the mortgagee would render the mortgagee agreement void and would be without legal support against the insurer unless consented to. Kase vs. Hartford Ins. Co., 58 N. J. 34.

A mortgagee who has sold his mortgage and has either guaranteed payment of the mortgage debt or endorsed the mortgage notes without taking the precaution to add the words "without recourse" has an insurable interest in the property which he should not lose sight of, for if an insurance company pays a loss to the assignee of the mortgage, for

which it is not liable to the mortgagor or owner, the company in the exercise of its subrogation rights can call upon the original mortgagee as guarantor or endorser for reimbursement.

It is the prevailing custom in New York City to make the following endorsement on policies no matter by whom presented:

> "The interest of .... mortgagee herein having ceased, loss, if any, is now payable to .... mortgagee."

without securing anything whatever in the shape of a release from the original payee. Considering the number of such endorsements which are made each year, it is really remarkable that so little trouble has arisen. There was a decision bearing on this point many years ago, in case of Reid vs. McCrum, 91 N. Y., 412. Policies on the buildings were endorsed "Loss, if any, payable to John Reid, mortgagee." Subsequently McCrum induced the insurers to cancel the endorsement and write on the policies as follows: "The mortgagee's interest having ceased, the loss, if any, is now payable to Hugh McCrum as owner." The mortgagee's interest had not ceased and after the buildings were destroyed by fire, the mortgagee brought an action to foreclose his security, making McCrum and the insurers parties defendant. It was quite properly held that the policies could not be legally changed without the assent of the mortgagee and that he was entitled to recover the loss from the insurers.

The question is frequently asked whether any liability accrues to a second mortgagee unless his security has been impaired by the fire, or whether under the mortgagee clause he can collect by reason of the mere fact that a loss or damage by fire has occurred to the property described in the policy; in short, whether it is loss to the second mortgagee's interest or loss to the property itself that determines the liability of the insurer.

It has been uniformly held that a first mortgagee under the mortgagee clause can collect the amount of loss to the property not exceeding his interest, notwithstanding the fact that the value remaining may be many times the amount of the mortgage debt, and even though it is self-evident that the first mortgagee has not and will not sustain any loss by reason of the fire. But the fact remains that his security is actually *reduced* and consequently *impaired* to the extent of the amount of loss by fire. He can therefore demand payment from his insurer, who will in turn be subrogated to the extent of the amount paid.

The foregoing reasoning appears to be perfectly logical as respects the interest of a first mortgagee, but a somewhat different situation is presented in connection with the interest of a second mortgagee, for under certain conditions the security of the latter may not be at all impaired by the fire. Can

he in such circumstances collect from his insurer? In answer to this question two diametrically opposite opinions have been expressed. One authority theorizes as follows, to wit:

"If a second mortgagee has a separate policy protecting his interest, he has a right to look to it for indemnity. Whether or not he sustains a loss depends upon conditions. There are circumstances under which a second mortgagee's interest may not be affected by a fire and, if not, he cannot collect anything under a policy made payable to him. For instance, if property should be sold and the new owner should take out a new policy with loss, if any, payable to the first mortgagee under a mortgagee clause, and the second mortgagee should hold a policy in the name of the former owner, with loss, if any, payable to the second mortgagee, the old policy would be void as respects the new owner. Then if the company which insured the new owner should pay the full amount of the loss to the first mortgagee, the interest of the second mortgagee would not be affected, because the amount of the first mortgage would have been reduced to the same extent that the property had been damaged, leaving the second mortgagee's interest relatively the same as it was and therefore sustaining no loss by the fire.

If two policies should be issued to the same owner, one payable to the first and the other payable to the second mortgagee, and a valid claim should arise under both, the first mortgagee could demand the full amount of the loss from his own insurer, in which event said insurer would be subrogated to the extent of the amount paid in excess of its pro rata liability to the owner. The first mortgage under these circumstances would be reduced only to the extent of said pro rata liability, and the second mortgagee could collect from the insurer its pro rata proportion of the loss, but no more.

By such a construction the second mortgagee gets all the benefit from his insurance that he is entitled to, namely, that his interest shall not suffer by any loss or damage by fire to the property."

Another authority advances the following argument, to wit: "While it is true that policies taken out in favor of mortgagees are in most of the States to be regarded as contracts of indemnity, they provide very explicitly how that indemnity shall be paid. It must be paid either in cash or by a reinstatement of the property itself; that is, in the case of a burned building, by a rebuilding. The insurance company in such cases cannot escape payment by showing that in reality the insured has suffered no actual loss. The insurance contract with the mortgagee is not in substance a guarantee of his debt or a guarantee that his collateral security shall continue of a certain value, but on the other hand, is to be construed as an insurance *on property* against fire loss *to that property;* and if a fire loss to that property occurs, then the insurer must either rebuild the property itself or pay the full amount

of the fire loss to the second mortgagee or to any other mortgagee, but not exceeding, of course, the amount of his interest, that is, the amount of his debt. In principle it matters not at all whether the mortgage is a first or a second mortgage.

"An insurance company has no authority to guarantee the payment of a debt. Its power is limited to insuring against such loss or damage as happens by fire *to property.* In insuring a mortgage interest it does not insure the debt, but the interest of the mortgagee in the property, upon the safety of which depends his security."

There does not appear to be any American decisions bearing directly on the interest of a second mortgagee, but there is an English decision which apparently supports the latter view. (Westminster Fire Offices vs. Glasgow Provident Investment Society [1888], 13 App. Cas., 699). That case had to do with two series of mortgage bondholders, the suit being brought by the second mortgage bondholders. The insurance companies defended on the ground that the entire amount of loss had been paid by the insurers of the first mortgage bondholders. But the English Court of Appeals decided that this was no ground of defense in whole or in part. But there is a dictum from one of the judges to the effect that if the money so paid had been actually employed *to reinstate the premises* then the decision might have been different on the theory that in that event the second mortgage bondholders would have sustained no loss. This dictum seems to lean to some extent at least toward the first of the foregoing opinions.

If the latter view is the correct one, and if a second mortgagee can collect the amount of his mortgage from the companies insuring his interest irrespective of whether or not his security has been impaired by the fire, it follows that in many instances, especially in times of real estate depression, a fire would be a veritable godsend, for his hitherto absolutely dead interest would instantaneously assume unexpectedly valuable proportions and the insurers would be compelled to pay a loss which had already accrued from causes other than fire.

This possibility directs attention very forcibly to the fact that separate policies containing the mortgagee clause should not be issued in favor of a second mortgagee, but when it is desired to protect said interest under a mortgagee clause, the form should read substantially as follows, viz:

"Loss, if any, under this policy shall be first payable to .... first mortgagee as his interest may appear; after the debt and interest secured by first mortgage shall be fully satisfied, the remaining loss, if any, shall be payable to .... second mortgagee as his interest may appear, subject to mortgagee clause hereto attached."

In connection with the "loss payable" or mortgagee clause, an interesting question arises which has received but little attention at the hands either of text writers or the courts,

and that is whether the words "as interest may appear" or "as interest shall appear" are descriptive of the interest existing at the time of the issuance of the policy or at the time of the fire. The Supreme Judicial Court of Massachusetts when called upon to decide the question, held that the words referred to the interest of the mortgagee as it existed at the time of the issuance of the policy, thus giving to the words a restricted rather than a comprehensive interpretation. This view has the effect of preserving to the insurance company the subrogation rights which were within its contemplation at the inception of the contract.

In the case of Attleborough Savings Bank vs. Security Ins. Co., 168 Mass. 147, the plaintiff, subsequent to the issuance of the policy, had taken a second and third mortgage on the property in addition to the one it already had, and contended that it was entitled to collect the amount due on all three mortgages by reason of the unrestricted nature of the phraseology descriptive of its interest, but the court held that the words used contemplated a possible decrease rather than an increase of the extent of the mortgagee's interest. It is doubtless on account of this decision that in Massachusetts the mortgagee clause is so phrased as to include the mortgagee's interest under present and all future mortgages covering the premises.

It would certainly seem that in the absence of an express agreement, the mortgagee should not be permitted to increase his interest at will and as a result possibly render valueless the insurer's subrogation right, but notwithstanding the high authority above referred to which has passed on the question, it is by no means certain that its decision will be followed in other jurisdictions, and it is not at all improbable that other tribunals equally distinguished may rule that in the absence of restrictive words in the mortgagee clause, it is the interest of the mortgagee at the time of the fire that is intended to be covered. If so, this would furnish an additional reason for the desire on the part of a junior encumbrancer to safeguard his interest by insurance entirely independent of that existing in favor of the senior mortgagee.

The belief is quite general among insurance companies that in event of neglect on the part of the mortgagor or owner to pay any premium due under the policy the mortgagee is legally liable therefor, but even as to this the courts are divided in their opinions. The Appellate Division of the Supreme Court of New York, Third Department, at the March, 1914, term in the case of Coykendall vs. Blackmer, held that the words "provided that in case the mortgagor or owner shall neglect to pay any premium due under this policy, the mortgagee (or trustee) shall on demand pay the same" is not a covenant, but only a condition, and that the only effect of failure on the part of the mortgagee to pay the premium is to deprive him of the special privileges accorded him in the

mortgagee agreement, and that he is not liable for the premium. One justice dissented from the principle enunciated, but decided against the plaintiff because he had not made the demand on the mortgagee within a reasonable time. This case did not come before the Court of Appeals. On the contrary the highest courts in North Dakota and Kansas have decided that the mortgagee is liable for the premium in case of default on the part of the mortgagor. The North Dakota Court said, "The clause provides that no neglect or act of the mortgagor, nor shall the vacancy of the premises invalidate the policy. If defendant's contention is sound, this provision would be nugatory if the mortgagor should pay the premium on time; for it is only in case of the mortgagor's default that the mortgagee can perform this condition of payment, and defendant insists that it is only on performance of such condition by him that he can have any rights under the mortgagee clause. This construction would destroy its effect in many cases. It would often deprive the mortgagee of any benefit from the provisions that he should not be prejudiced by any act or neglect of the mortgagor by reason of vacancy, etc. of the premises. The mortgagee clause gave the mortgagee immunity from certain forfeitures resulting under the policy from the mortgagor's acts or omissions, and the mortgagee in turn agreed to pay for this immunity the premium in case of the mortgagor's default. This is the clear import of the agreement." The Kansas Court said, "While the word 'provided' ordinarily indicates that a condition follows, there is no magic in the term, but the clause is to be construed from the words employed and from the purpose of the parties gathered from the whole instrument." St. Paul F. & M. Ins. Co. vs. Upton, 2 N. D. 229, 53 Pac. 472; Boston Safe Deposit & Trust Co. vs. Thomas, 59 Kan. 470, 53 Pac. 472.

The company reserves the right to cancel the policy at any time as provided by its terms, but in such case the policy shall continue in force for the benefit only of the mortgagee for ten days after notice to the mortgagee of such cancellation and shall then cease, and the company shall have the right on like notice to cancel the mortgagee agreement. It will be noticed that there are two ways of getting rid of liability to the mortgagee, one by cancelling the policy and the other by cancelling the mortgagee agreement. The policy cannot be legally cancelled in less than five days, unless by waiver on part of the insured: hence "ten days after notice to the mortgagee of such cancellation" may mean fifteen days and perhaps more from date of original notice to the insured. But the mortgagee agreement, the vital principle as regards the mortgagee's interest, can be cancelled by ten days' notice, and too much care cannot be taken to see that notices are properly worded. The following is suggested as a legal form of notice to the mortgagee:

"We elect to cancel the mortgagee agreement attached to and made a part of our Policy No. .... issued to .... through our agency at .... on .... 19 , covering on .... at .... and made payable to you as mortgagee (or trustee), in event of loss, and hereby give you ten days' notice thereof, as provided by the terms of said mortgagee clause.

"Take notice that on the .... day of ...., 19 , at twelve o'clock noon or, if that date is not ten days from the receipt hereof, then at the expiration of ten days from its receipt, the said agreement will terminate and cease to be in force."

Although, except in the seven States previously referred to, a mortgagee under the plain "loss payable" clause cannot collect if the policy is void as to the mortgagor or owner, he being bound presumably, by all the policy conditions preceding line 59, all the courts which have passed directly upon the question have held that a policy cannot be cancelled as to the mortgagee, without notice. But the cancellation provision is in line 51, and notwithstanding the seeming inconsistency in holding that the mortgagee is bound by some of the provisions preceding line 56 and not by others, it is quite evident that under the various "loss payable" clauses in current use, the courts are inclined to distinguish between forfeiture and cancellation and to hold that in order to effect legal cancellation as to the mortgagee's interest he must receive notice. A clause could no doubt be prepared which would relieve the insurer of this necessity, but a policy containing such a provision would lose much, if not all, of its value for collateral purposes and be manifestly unfair to the mortgagee. As a matter of prudence notice should be given both to the insured and the payee regardless of whether the cancellation is by the insured or the company.

It has been held in many well considered cases (although there are some views to the contrary) that a covenant by a mortgagor to keep the buildings upon the mortgaged premises covered by insurance for the benefit of the mortgagee, and in event of default thereof authorizing the mortgagee to effect such insurance at the expense of the mortgagor, is only a personal covenant of the mortgagor obligatory upon him alone, and is not a covenant that "runs with the land" or which follows the title; and hence does not bind a subsequent grantee of the mortgagor to keep insurance for the benefit of the mortgagee, nor can premiums paid therefor be recovered of such grantee, nor tacked to the mortgage, even though his deed may have been made subject thereto; nor is the record of the mortgage sufficient legal notice to bind either the grantee or subsequent mortgagee. Dunlop vs. Avery, 89 N. Y. 592; Reid vs. McCrum, 91 N. Y. 412; Farmers Loan & Trust Co. vs. Penn. Glass Co., 186 U. S. 434.

The closing paragraph of the mortgagee clause has reference to subrogation when there is no liability to the mortgagor or owner, it being very properly stipulated that no subrogation shall impair the right of the mortgagee (or

trustee) to recover the full amount of his claim. This right of subrogation is about the only consideration for the mortgagee agreement and affords the only excuse for such a contract being entered into.

When the policy is in favor of a first mortgagee on property where land values are high, subrogation is a valuable right, but when the policy is in favor of a second or third mortgagee its value approaches and frequently reaches the vanishing point, and it is on this account that some companies decline as a matter of general practice to issue a mortgagee clause in favor of a second and third mortgagee.

The agreement provides that whenever the insurance company shall pay the mortgagee (or trustee) any sum for loss or damage under the policy and shall claim that, as to the mortgagor or owner, no liability therefor existed, the company shall, to the extent of such payment, be thereupon legally subrogated to all the rights of the party to whom such payment shall be made, or may at its option, pay to the mortgagee (or trustee) the whole prinicipal due or to grow due on the mortgage and shall thereupon receive a full assignment and transfer of the mortgage and such other securities. This would seem to be about as clear as it is possible for language to make it, and would indicate to the lay mind that the insurer would have a perfect right even arbitrarily to deny liability to the mortgagor and insist upon the mortgagee complying with the conditions of the agreement, and leave the mortgagor to pursue his remedy under the policy in the courts if he so desired; but the courts say that the clause shall not be construed to vest in the insurance company the right to subrogation upon the mere assertion of claim unfounded in fact; that the claim which it may assert must be valid and well founded. The Supreme Court of Canada has held that the insurance company is not justified in paying the mortgagee and claiming subrogation without first contesting the liability of the mortgagor and establishing its immunity from liability to him, and that is practically the position of those courts in this country which have passed on the question. In short, the mortgagee, if he desires, may decline to accept payment of the loss (although he seldom does) and insist upon a decision from the court of last resort as to whether there is a liability to the mortgagor or owner, before he will be compelled to comply with the subrogation provision. The latest decision is that of O'Neill vs. Franklin Fire Ins. Co. in which the Court of Appeals of New York affirmed without opinion the decision rendered by the Appellate Division, 159 App. Div. 313, 216 N. Y. P.——— 43 Ins. Law Journal 388. See also Traders Ins. Co. vs. Race, 142 Ill. 338, 31 N. E. 392; Anderson vs. Saugeen Mut. F. Ins. Co., 18 Ont. Rep., 355; Bull vs. North British Canadian Investment Co. & Imperial Fire

Ins. Co., 15 Ont. Rep. 421, affirmed 18 Canadian Supreme Reports, 697 Loewenstein vs. Queen Ins. Co. (Mo. S. C.) 39 Ins. Law Journal, 877.

To the mind of the writer the dissenting views which were expressed in some of these cases are much more reasonable, logical and convincing than the prevailing opinions and the following quotation from the dissenting opinion of Justice Kruse in the O'Neill case (supra) undoubtedly sets forth the intention of the framers of the mortgagee agreement.

"I think the insurance company was entitled to an assignment of the mortgage. As between the mortgagee and the insurance company, it was not necessary for the insurance company to show that it was not liable to the mortgagor and owner upon the policy. The insurance company made that claim and offered to pay the mortgagee the whole principal due or to grow due, with the interest, and demanded an assignment of the mortgage. Whether or not the insurance shall be applied as a payment upon the mortgage is a question between the mortgagor and the insurance company, in which the mortgagee has no interest. I think the mortgagee has no standing to contest that question with the insurance company."

The Chancery Court in New Jersey in the case of Florence E. Palmer vs. John A. McFadden, Guardian, and Niagara Fire Ins. Co., has recently handed down a decision, which should certainly be reversed on appeal. The Niagara, whose policy was the only one of three which was payable to the mortgagee under a mortgagee clause without contribution, paid the mortgagee $3,416.67 and took an assignment of the bond and mortgage, but its pro rata liability to the insured was only $1,388.16, or $2,028.51 less than the amount paid. The court ruled that because the mortgagee clause did not contain the contribution provision, and because the insurer admitted *some* liability to the insured, as distinguished from *no* liability, the insured was entitled to have the bond, mortgage and decree of foreclosure surrendered for cancellation. In short, the lower court virtually handed the insured $2,028.51, and if the judgment is affirmed, she will have made just that much clear profit by the fire.

The insurer should, equitably, be subrogated to the extent of the excess payment, even in the absence of an agreement for subrogation, and it is not conceivable that this decision, based as it is upon a strained and distorted view of the subrogation provision, will be permitted to stand. (Note: This decision was subsequently reversed.)

A new mortgagee clause is now being considered by various underwriting organizations and no doubt will soon be promulgated for use in states where the present standard form is not required by law. It contains a fair contribution provision and expressly stipulates that the insurer shall be subrogated to the extent of any excess sum for loss or damage over and above the amount of its liability to the mortgagor or owner, thereby covering the point raised by the New Jersey Court in the Niagara case (supra).

In the absence of an agreement, express or implied, or of a clause in the policy making the loss payable to the mortgagee, or of an assignment to the mortgagee, the mortgagee has no interest in a policy taken out by the mortgagor upon his own interest, and conversely a mortgagor has no interest in the proceeds of a policy taken out in the name of the mortgagee for the purpose of protecting his interest only.

Where a policy is made payable to a mortgagee "as his interest may appear," there is a conflict of authority as to whether the mortgagee is entitled to the proceeds arising from the destruction of property included in the policy, but not covered by the mortgage. Cooley's Briefs, 3699-3700.

In Massachusetts, Minnesota, Mississippi and North Carolina, by statute, if by an agreement with the insured or by the terms of a policy taken out by a mortgagor, the whole or any part of the loss is to be paid to mortgagees, the company may pay the mortgagees in the order of their priority of claim and such payment shall be, to the extent thereof, payment and satisfaction of the liability of the company. In Maine, by statute, the mortgagee of real estate has a lien upon any policy of insurance against loss by fire procured thereon by the mortgagor, to take effect, if the loss has not been paid, after filing of a written notice with the company. Cooley's Briefs, 3703-3704.

A senior mortgagee whose mortgage provides for insurance has no lien on the proceeds of a policy which by the terms of the policy is made payable to a junior mortgagee, except to the extent of the excess, if any. Dunlop vs. Avery, 89, N. Y. 592.

If a mortgagor complies with the mortgage agreement and takes out insurance for the benefit of the mortgagee and the insurance company becomes insolvent, the mortgagee has no lien against insurance taken out by the mortgagor to protect his own interest. Nordyke & Marmon Co. vs. Gery, 112, Ind. 535, 13 N. E. 683, 2 Am. St. Rep. 219.

The interest of a mortgagee under the mortgagee clause or "loss payable" clause takes precedence over that of an assignee or trustee in bankruptcy, an assignee of claim or an attaching creditor. The equitable interest gained by an assignment of a policy as collateral security will prevail over the claim of an unsecured creditor garnisheeing the company. Wakefield vs. Martin, 3 Mass. 558. The lien of a mortgagee who has been promised insurance, is superior to that of an assignee of the policy after loss, who takes with knowledge of the equity of the mortgagee (Nichols vs. Baxter, 5 R. I. 491) or whose assignment is supported only by a precedent debt. An assignee of a mortgage containing a covenant to insure was held entitled to priority as to a policy taken out by the mortgagor, over an assignee in insolvency of the mortgagee. Branch vs. Milford Sav. Bk., 51 Kan. App. 246, 47 Pac. 555.

The right of an attaching creditor has also been held subordinate to this lien; Providence County Bank vs. Benson, 24 Pick (Mass.) 204. But where the claim under the policy has been assigned after a loss to an innocent purchaser for value, it has been held that his equity was superior to that of the mortgagee. Swearingen vs. Hartford Fire Ins. Co., 56 S. C. 355, 34 S. E. 449. The lien of an assignee of a mortgage, who has been promised insurance by its assignor, is enforceable as to insurance taken out by his assignor after the purchase by such assignor of the mortgaged property. Hyde vs. Hartford Fire Ins. Co. (Neb) 97 N. W. 629. Cooley's Briefs, 3706.

It will be freely conceded that those who loan money on real estate are entitled to fire insurance protection unaffected by the acts or neglect of parties other than themselves. The contracts in their favor must necessarily be less restrictive in their terms than those in favor of the property owners, but the propriety of granting indemnity to a mortgagee under any kind of special contract attached to the policy of the mortgagor without some special consideration is, to say the least, a matter of grave doubt, to say nothing of granting him a contract almost—if not entirely—free from conditions, for no consideration other than the right of subrogation, which in many instances may be of no value whatever.

Although much has been said and written on this important subject and many decisions have been rendered, still the last word has not yet been spoken and we may confidently expect new phases of the question to present themselves for consideration and adjudication.

Fire Loss Settlements

FIRST LECTURE

BY

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Fire Loss Settlements

First Lecture

The new Standard Fire Insurance Policy of the State of New York, under the head of "Requirements in Case of Loss," states in part:

"The insured shall give immediate notice, in writing, to this Company, of any loss or damage, ..."

By this is meant that the insured or his legal representatives shall, either personally serve upon the insurance company's authorized agent, or shall place in the mails a written notification of the loss, addressed to the agent or to the company, and in said notice a mere statement giving the policy number and date of the loss should suffice. We have numerous decisions under the old form of policy where a question has been raised by the insurance company as to the meaning of "immediate notice," the trend of which would seem to place upon the insured the responsibility of compliance with this very essential condition of the policy within a reasonable number of days, provided no unusual circumstances prevented. For instance, it has been held that from eleven to fourteen days could not be said to have been "immediate notice." If, on the other hand, the insured, through a chain of circumstances, was unable to notify the company in writing within two or three weeks, I am very much inclined to believe that the average court would place upon the jury the entire responsibility of determining whether the insured could be said to have acted with due diligence. A verbal notice to an agent could not be said to be an act on the part of the insured in compliance with this condition of the policy.

The layman would ask, why should an insurance company rigidly insist upon strict compliance with the foregoing provision. In answer to this it could be said that in the event of a partial loss, the salvage or what remains would be adversely affected by the insured's failure to give immediate notice, and again—in the event of say a total loss, the insurance company would not have an opportunity of viewing

the remains, nor of investigating the cause of the fire until the general public had been given access to the premises, and by either walking upon the debris or carting away portions of the salvage, had so materially changed the appearance of the premises as to lead an adjuster to view the situation from an entirely different aspect.

Following the above provision, the present New York Standard Fire Policy goes on:

> "Protect the property from further damage, forthwith separating the damaged and undamaged personal property, put it in best possible order, furnish a complete inventory of the destroyed, damaged and undamaged property, stating the quantity and cost of each article and the amount claimed thereon................;"

There is probably no vital condition of the policy more universally disregarded at the expense of the insurance companies than this very reasonable requirement. The reason, leaving out the question of fraud, is undoubtedly apprehension on the part of the insured that his act may be construed to his eventual disadvantage. He is usually told, particularly by those who furnish free advice, that he should do nothing until the arrival of the adjuster. A perishable stock may be involved, and the company, through failure to receive prompt advices, may not be able to arrange for an inspection by its adjuster for a week or ten days following the fire, and in this period of time if the insured does not attempt to protect the property from further damage, a total loss may result. Fortunately insurance companies are blessed with a very high degree of intelligence in the personnel of their local representatives, and it is seldom that salvage is permitted to greatly deteriorate without some effort being made to protect or preserve the interests of all concerned.

Another feature which no doubt acts as a deterrent to the insured is his fear that a separation of the damaged and undamaged property and a general clean-up of the premises will reduce the extent of the true loss in the eyes of the adjuster. This belief is utterly unwarranted, and if through educational means the public could be led to realize that their interests would not be adversely affected by a compliance with this condition of the policy, adjustments would be easier for all concerned, and losses of magnitude would be settled with greater dispatch and less delay and friction. The average insured has, as a rule, no idea of the true loss in the event of a partial loss, whereas if he would comply with the foregoing condition of the policy,—and in doing this he would be forced to inspect each item of merchandise or property,—he would, following a separation of the damaged and undamaged property and the preparation of a complete inventory, be in a decidedly better position to present his claim in an intelligent manner.

In scheduling damaged property, the item should be extended on the basis of the cost price, and upon each item

the insured should assess the damage claimed. The manner in which the adjuster arrives at the Sound Value and Loss and Damage will be treated later.

Following the above quoted provision of the policy, the New York Standard Form continues:

> "The insured shall, within sixty days after the fire, unless such time is extended in writing by this Company, render to this Company a proof of loss, signed and sworn to by the insured, stating the knowledge and belief of the insured as to the following..........................."

This clause as it reads, is, of course, very easy to understand, though unfortunately the various states have either enacted laws or permitted decisions whereby there is great variance in the respective positions. For instance, New York State has rigidly adhered and given full support to this condition of the policy, and in consequence if an insured does not within sixty days—unless such time has been extended by the company—file some form of paper which may be said to be in substantial compliance with this provision, all right of recovery under the policy involved is forfeited. However, as compared with this, the state of New Jersey forces an insurance company to make a demand upon the insured for compliance with this provision, and in addition furnish said insured with a blank Proof of Loss. Other states vary in their position, and it is therefore, necessary to consider the subject with reference only to a specific state. In New York State, as stated, Proof of Loss must be served upon the company or its duly authorized agent within sixty days, and by this is meant not sixty-one days, but exactly *within* sixty days.

The form of policy under consideration following the above condition goes into considerable detail as to what shall constitute a Proof of Loss, and any individual of average intelligence should have no difficulty, even without the assistance of technical advice, in complying with this provision. The policy requirement following the last quoted provision, states:

> "Render to this Company a proof of loss, signed and sworn to by the insured, stating the knowledge and belief of the insured as to the following: the time and origin of the fire, the interest of the insured and of all others in the property,"

By interest of the insured and others in the property is meant those individuals or business concerns which may be interested either as sole or part owners or as mortgagees or lienors.

The policy requirement proceeds:

> "the cash value of each item thereof and the amount of loss or damage thereto,"

One of the most difficult problems of an adjuster is to secure the insured's agreement to what may be termed, the "Cash Value" of the property involved at the time of loss. What may have been paid for property prior to the loss does not necessarily govern as to the sound value at the time of the loss. For instance, the market value of the commodity

involved may have either noticeably increased or decreased since its purchase by the insured. In considering a fair and reasonable interpretation of what constitutes cash value, it should be borne in mind that the New York Standard Fire Policy covering real or personal property, is a contract of indemnity; it is never a wagering contract, nor is it a gambling agreement—barring of course any added provision to the contrary. Its provisions when taken together are drawn in order to indemnify the insured *for what may have been lost,* less, of course, any proper deduction by reason of the application of such subsequent or added provision as Co-insurance, Average or Three-quarter Value Clauses. If, therefore, in reaching an agreement with an insured as to the meaning of cash value, a figure should be arrived at exceeding either the true value of the property involved or the cost to replace at time of fire, an amount will be paid exceeding the true intent of the policy as well as the legal indemnity or protection afforded thereunder.

In the beginning or on the face of the policy, you will appreciate the company agrees to insure

> "John Doe, and legal representatives, to the extent of the actual cash value (ascertained with proper deductions for depreciation) of the property at the time of loss or damage, but not exceeding the amount which it would cost to repair or replace the same with material of like kind and quality within a reasonable time after such loss or damage, without allowance for any increased cost of repair or reconstruction by reason of any ordinance or law regulating construction or repair and without compensation for loss resulting from interruption of business or manufacture, etc."

This provision gives the company the right to insist upon an adjustment based upon the actual cost to replace the property damaged or destroyed at time of fire, and in the case of several commodities the "market price" has been accepted by the companies as a proper basis of adjustment. The better or more universally known commodities where a market quotation at or nearest the scene of the loss governs, are grain and cotton. The justice of fixing the sound value on basis of market quotation in the case of these two staple products, is due to the fact that the cost to produce is almost an unascertainable quantity, so far as the average insured is concerned, as due to the existence of "exchanges" in several of our larger cities, both cotton and grain are freely traded in, and in consequence numerous changes occur in ownership. In the case of commodities where there is no market quotation, the proper basis of adjustment in fixing the sound value is to ascertain the cost to produce in the event that no change has taken place in either cost of labor or the cost of the items which go to make up the finished product, provided of course, the property in question cannot be replaced at less than cost to produce.

In the event that there is no provision in the policy concerning the basis of adjustment, other than the foregoing

provision, the market price as well as the cost to produce is the universally accepted and proper basis of adjustment, and never in any instance is the sales price to be used in computing the sound or actual cash value. The sales value may be covered, but this must be clearly stated in the policy, or the anticipated profits may be covered, but this must also be clearly provided for in the contract.

After the insured has prepared a statement setting forth the cash value at time of loss, the loss or damage should be extended under each item and the total, of course, may be said to be the most vital feature of the entire insurance contract. A proper, reasonable and just manner of fixing the loss or damage on each item involved is reached in the case of say a retail merchant, by taking into consideration the basis upon which the damaged merchandise may be sold at the same percentage of profit as would have been obtained from the undamaged merchandise, had there been no loss. That is, the insurance company cannot expect to force a merchant to continue in business selling damaged merchandise without obtaining a reasonable profit for his efforts. In other words if a stock of merchandise could be said to have an actual cash value at time of loss of $10,000 and it could also be said that the merchandise in question had been damaged to the extent of 50%, then the ordinary interpretation would be that the insurance company should pay $5,000. This would be a fair and reasonable settlement, provided the merchant could dispose of the damaged goods for $5,000 plus a reasonable profit. The insurance company could not expect to force the merchant to continue business for several months and merely obtain the net sum of $5,000 but must in addition, be willing, as stated, to afford the insured the opportunity of making a reasonable profit from the continued sale of the damaged goods, unless by agreement all salvage should be sold as a unit.

Quoting further from the policy provision with reference to the insured's duty in connection with filing a proof of loss, it is stated the insured shall

> "render to this Company a Proof of Loss................stating................ all encumbrances thereon, all other contracts of insurance, whether valid or not, covering any of said property,"

By encumbrances is meant a mortgage or lien granted by the insured to another, usually as a result of money obtained as a loan by the owner of the property involved. All insurance, whether valid or not, must be fully set forth in the proof of loss. For instance, several policies involved may be said to be invalid and the insured may be utterly unable to recover anything as a result of the loss, but notwithstanding this the invalid policies in question must, at least in the statement or apportionment of the total insurance, bear their proportionate part of the loss.

The insured is further required to note:

"any changes in the title, use, occupancy, location, possession or exposures of said property since the issuing of this policy."

By this is meant that the insured must incorporate or state in the proof any information concerning a sale of any or all of the property covered, and also any change in the use to which the property may have been put, such as changing an ordinary dwelling to a hotel. If any property has been moved from the location as stated in the policy, this must be clearly shown in the proof, or if a change in possession has occurred, this must be incorporated. The insured is further required to note in the proof any exposures, such as new buildings or property placed or erected near the subject of insurance since the issuance of the policy.

Continuing the policy requirement:

"By whom and for what purpose any building herein described and the several parts thereof were occupied at the time of fire."

The insured is required to insert in the proof a statement giving the names of occupants and the nature of their business at the time of the loss.

The policy requirement further continues:

"and shall furnish a copy of all the descriptions and schedules in all policies and if required, verified plans and specifications of any building, fixtures or machinery destroyed or damaged."

The latter part of this requirement, you will note, is not a mandatory one, unless the insured shall be notified by the company that such information must be furnished. In those cases, however, where the insurance company makes specific demand upon the insured for the production of the data specified, proper or reasonable compliance on the part of the insured must be shown.

Continuing the policy requirement:

"The insured, as often as may be reasonably required, shall exhibit to any person designated by this Company all that remains of any property herein described, and submit to examinations under oath by any person named by this Company, and subscribe the same."

The effect of this condition is that the insured must exhibit or show to the company representative all that remains of any property involved, and the insured must also submit to an oral examination under oath, either at the scene of the loss or a location agreeable to both parties at interest. The company cannot require the insured to make a specific trip to its office to answer under oath questions and interrogatories, but must designate a reasonable place. The insured's failure to appear for examination under oath at a designated reasonable time and place is a bar to recovery under the policy. On the other hand, the insurance company must not make an unreasonable or improper demand either as to time or place. That is, the insurance company should not wait until approximately the expiration of sixty days from the date of proof and then demand an examination under oath, but if it desires

to avail itself of this privilege or condition of the policy, the examination under oath must be demanded within a reasonable time after the proof of loss has been filed by the insured, and by reasonable time could probably be said to be, at any time within the sixty days following the serving of the proof, provided the date set for the examination is previous to the expiration of the sixty days. After the insured has submitted to an examination under oath, he is required to subscribe the same as the foregoing condition recites, though his failure to do so will not result to the insurer's disadvantage in the event the oath has been administered to the insured at the beginning of the examination.

"Requirements in case of loss" as embodied in the policy concludes:

> "and as often as may be reasonably required, shall produce for examination all books of account, bills, invoices, and other vouchers, or certified copies thereof, if originals be lost, at such reasonable time and place as may be designated by this Company or its representative, and shall permit extracts and copies thereof to be made."

Under this condition the insured if requested is required to obtain duplicate bills showing the cost of the property involved, in the event he cannot produce the originals, and again, all books of account must be presented for the company's examination at such reasonable time and place as may be designated. The insured's failure to show a reasonable compliance with this condition would undoubtedly result in his failure to make a recovery under the policy.

In the entire foregoing, stress or emphasis has been laid on the duty of the insured in the event of a loss. In the following an attempt will be made to briefly set forth the duty of the insurer.

After the insured has given immediate notice of the loss, and has to the best of his ability protected the property from further loss or damage, the insurer must arrange to have a representative act with the insured in an attempt to determine the value of the salvage as well as the amount of the loss, and failing so to do, must bear the consequences of any further loss or deterioration of the salvage by reason of its inaction. For instance, in the case of loss on a perishable stock of merchandise, the insurer could not, several weeks after the date of the loss, and after having received due notice, maintain its position in alleging that the insured had used poor judgment in handling the salvage where it had given the insurer no advice nor made any attempt to arrange for an inspection of the damaged property by an agent or adjuster. If the insured could demonstrate that he had used due diligence in protecting the property, the insurer could not after its failure to act penalize the insured for merely improper judgment.

The appraisal condition of the new New York Standard policy is radically different as compared with the old. For in-

stance, the new form provides that following the selection of competent and disinterested appraisers by the insured and the insurer, an umpire shall be selected by the appraisers so chosen, though failing for fifteen days to agree upon such umpire, then upon request of the insured or the company such umpire shall be selected by a judge of a Court of Record in the city in which the property insured is located. The old form policy still in use in some other states contained no provision concerning the selection of an umpire other than to state that it was the duty of the two appraisers to select such umpire. This of course resulted in numerous deadlocks. That is, the two appraisers could not agree upon an umpire and so reported to the insured and insurer, and in consequence either a new appraisal was resorted to or the insured, upon failure of the appraisal, thereupon filed suit. Theoretically the new appraisal condition is fair and reasonable. Prior to entering into an appraisal there must be a failure to agree as to the amount of loss or damage and the appraisal condition of the policy may as stated be resorted to by the insurer or the insured upon written demand of either. Failure to comply with a demand for an appraisal would constitute a bar to recovery by the insured, and likewise if the company failed to comply with the insured's demand it could not then allege failure to complete an appraisal, as a defense in event of suit, but must allow the jury to fix the loss or damage in the event it should be held liable for the loss.

In the absence of fraud, the award of any two of the two appraisers and umpire so chosen, will be definitely binding upon the insurer as well as the insured as to the sound value and loss or damage. An appraisal award may be set aside by presentation of evidence by either party showing collusion or bad faith on the part of the appraisers and again, it is probable that an award would be ignored or set aside by the court in the event definite proof could be submitted that a glaring error of magnitude had been made, provided it could be clearly shown that the error had been committed by the appraisers making the award.

The average layman views the nomination of appraisers as the selection of representatives of either side, though such is entirely contrary to the meaning as well as the wording of the policy, which states that the insured as well as the company shall select "a competent and disinterested appraiser."

Following the insured's compliance with all conditions of the policy including those demanded by the company in addition to those as incorporated in the policy, the company under the New York Standard form of fire policy is required to pay the amount ascertained to be due within sixty days following the receipt of proof of loss or the filing with the company of an appraisal award as provided. Upon failure of the company to pay the loss within the required time, the right of an action at law instantly accrues to the insured.

Lines 182, 183 and 184 of the New Standard Fire Policy of New York states:

> "but there can be no abandonment to this Company of any property."

While this should be a very easily understood condition of the policy, it can be safely said that there is as much misconception as to the company's or the insured's option in this respect as to any other feature of the policy contract. The average layman seems to feel that once a loss has occurred the remaining property belongs to the insurer. Such, however, is not the case under the fire policy, and no court has, as yet, rendered a decision which would be in the slightest contrary to this statement, unless of course, some adverse act of the insurer should have created an unusually peculiar situation constituting a waiver. Any remaining property, regardless of its value or its condition, is the property of the insured, and as stated, there can be no abandonment to the insurer in the absence of an agreement to the contrary.

The company has the option, however, to take all or any part of the articles involved in a loss at the agreed or appraised value, and in addition has the added option of repairing, rebuilding or replacing the property lost or damaged with other of like kind and quality within a reasonable time, though the company must give notice of its intention so to do within thirty days after the receipt of the proof of loss.

It is seldom indeed that the insurer takes advantage of the option to repair or replace the property lost or damaged, though it frequently happens that the company accepts abandonment of the salvage; the latter being usually the result of failure to agree upon the value of the salvage and the adjuster's idea that more may be obtained by taking possession of and selling same for the benefit of the company rather than by paying the loss demanded by the insured and in consequence leaving all damaged property in his possession.

In probably ninety-nine cases out of one hundred, the insured gives verbal notice to the agent, and the agent in turn gives written notice to the company. An adjuster is promptly named and immediately visits the scene of the loss, and in a great majority of the cases an amicable adjustment is arrived at with great dispatch; proofs of loss submitted, and the loss instantly paid. It is seldom indeed that the company takes advantage of its privilege to refrain from payment until the expiration of sixty days from the date proof is filed. The adjuster, as a rule, assists the insured in every possible manner, with reference to the conservation, handling and disposition of the damaged property as well as in the preparation of the proof of loss. In the larger business centers numerous individuals are engaged in the business of representing the insured in the adjustment, and in some states the position of adjuster for the insured is legally recognized, and such individuals are licensed by the state.

It can be safely stated in comparing procedure in fire loss settlements with procedure in connection with the payment of obligations arising under contracts, that there is probably less red tape or technical evasion resorted to than in any other business. For instance, under the policy contract there is no obligation upon the company, except in certain circumstances, to present the insured with a blank proof of loss or assist in the preparation of said proof, though unless the insured is represented by a licensed public adjuster, a great majority of insurance adjusters relieve the insured of all detail in connection with the completion of a proof of loss.

The average insured seldom, if ever, reads the policy contract until a loss occurs, but, notwithstanding the fact that a certain percentage of policies can be said to be void due to acts or omissions of the insured, few companies endeavor, in the absence of fraud, to take advantage of the situation which exists. Instead, as a general rule, an amicable adjustment is reached with the insured, based upon the merits of the case, and prompt payment is made without delay, undue formalities and unreasonable or technical requirements.

Fire Loss Settlements

SECOND LECTURE

BY

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Fire Loss Settlements

Second Lecture

In our discussion of the subject of "Fire Loss Settlements" up to this juncture we have given special consideration to "requirements in case of loss" on the part of the insured, and perhaps it will not be amiss at this time, without attempting to lay down any definite rules, to outline the usual or customary procedure on the part of the company's adjuster or representative.

As already explained, the usual procedure following the actual occurrence of a fire is a verbal notification by the insured to the agent who in turn either writes or telegraphs the company interested. An adjuster is promptly dispatched to the scene of the loss in the event the claim exceeds $100, and if under this figure the agent usually acts as the adjuster. Immediately upon arrival at or near the scene of the loss the adjuster, in accordance with custom and courtesy, first calls upon the company's local agent who in turn introduces him to the insured.

Naturally the first impression formed upon the mind of the adjuster, as well as of the insured, as to the personal characteristics or make-up of either is quite important. If the adjuster creates an unfavorable impression upon the insured, it is needless to say that he will enter into the adjustment under a considerable handicap, though by his later attitude he may be able to entirely overcome this feeling. On the other hand the insured may adopt such thoroughly improper or unreasonable tactics that the adjuster may form a premature opinion which could not be said to be altogether favorable.

As previously explained, many insured seem to be under the impression that once a loss has occurred all salvage becomes the property of the company and probably one of the first duties of an adjuster is to explain in as diplomatic a manner as possible that such is not the case.

Many misunderstandings which occur during an adjustment are frequently overcome by reference to the company's local agent as intermediary. The local agent, of course, legally represents the company, though at the same time he has a distinct moral obligation to the insured up to the extent of straightening out, if possible, all difficulties which may arise with justice and full consideration for the rights of all concerned.

An agent well versed in loss procedure, and in addition with a knowledge of the insurance contract, is an asset to an adjuster which should not be overlooked.

No set rule can be laid down as to procedure in a fire loss settlement, as each case is so distinctly different that a rule which might properly apply to one loss would be entirely out of order in another instance.

After the agent has discussed the loss with the company's adjuster and the latter has gotten in touch with the insured, the customary procedure is to ascertain, if possible, the cause of the fire, and naturally if no criticism is to be directed toward the insured, it is the next duty of the adjuster to take up for consideration the policy contract. That is, he should first endeavor to ascertain what interest the insured has in the property involved and, without putting his questions in the form of a legal examination, should endeavor to ascertain whether all requirements in the policy have been substantially complied with.

Where an adjuster ascertains that a vital condition of the policy has been ignored by the insured, or becomes aware of the fact that the insured by some act has voided an essential condition thereof, it is the duty of the company representative at once to bring to the attention of the insured the fact that, inasmuch as the contract has been violated, it will be necessary for both parties to agree that all further discussion or consideration of the loss is to be without prejudice. In order to do this it is necessary for the insured as well as the adjuster to jointly execute what is known as a "non-waiver" agreement. This agreement is simply a statement to the effect that the act of the adjuster in further investigating and attempting to determine the amount of the loss shall be done without any commitment on the part of the company or without infringement upon the rights of either. In other words, it is an endeavor on the part of the company to preserve the rights, which properly have already accrued to the company, and in addition with as little trouble as possible to ascertain by definite agreement, if this can be done, the true amount of the loss sustained.

Practically no company at this time is in the habit of making a flat denial of liability immediately upon becoming aware of a serious violation of the policy contract, but instead they, as a rule, wish to proceed further in order to determine the amount of the loss.

The average insured, when being confronted with this situation, as a rule seeks legal advice unless perchance he has every confidence in the company's local agent, in which event there is seldom any delay in agreeing to the adjuster's proposal that he sign a "non-waiver" agreement.

For some unknown as well as some unascertainable reason an occasional public adjuster, i. e., the adjuster who represents the insured and not the company, advises his client not to sign a "non-waiver" agreement, evidently proceeding upon the presumption that by so doing he would acknowledge the existence of a policy violation. As an offset to this I would say that I do not recall one single instance in my, it is true, short career as an insurance adjuster, where the insured's act in signing a "non-waiver" agreement has reacted to his disadvantage; on the contrary I think the average court would look upon this as a clear evidence of the insured's good faith as well as his desire to do anything within reason as suggested by the company.

Analyzing the procedure in connection with adjustments under various classes of losses it might be said that there are two separate and distinct methods; one being the careful and very proper procedure of the conscientious adjuster who endeavors in a detailed and proper manner to ascertain the true loss. If such an adjuster is unfamiliar with the class of property damaged or destroyed, he invariably seeks technical advice and before making the insured an actual offer of settlement is, as a rule, quite positive as to the true facts in the case.

The other class of adjusters, who are decidedly in the minority, are those individuals who make what may be termed "jump" settlements, i. e., following a superficial examination of the loss, make the insured an offer in round figures of so much money. Probably in a great percentage of these cases, the insured himself does not know the true extent of the loss, and where a loss is settled on basis of a "jump" estimate and it later develops that it has been considerably underpaid, the company will secure unfavorable though properly earned notoriety, and in the reverse case the insured will reap a decided profit as a result of a settlement in this manner.

The act of any adjuster who adopts the "jump" estimate basis of settlement is to be greatly regretted, as it is, I believe, almost a physical impossibility for any one individual to tell at a glance just what a loss may or may not be.

It is quite true that a "jump" settlement greatly reduces the necessity of detailed work or trouble as well as annoyance on the part of all concerned, but inasmuch as a settlement on this basis has such serious disadvantages as well as comebacks, it is hoped by, I believe, a great majority of the companies that no insured will accept settlements on this basis.

Of course where grave doubt exists as to the extent of a loss and no amount of careful analysis or detailed work, as

well as technical advice, will avail as to fixing by agreement the true amount of the loss, then it very frequently happens that a round figure is agreed upon in compromise, though it is clearly understood that such figure is a compromise settlement and there can, therefore, be no comeback on the part of either.

It is my impression that competent insurance brokers, who have the interest of their clients at heart, would much prefer to deal with a careful, thoroughly reasonable adjuster than with an individual who preferred to settle all losses by simply naming a round figure without going fully and carefully into the details of the case. The broker would realize in the first instance, that he would receive the same form of consideration and treatment on all losses, whereas in dealing with the other type of adjuster, he would be apprehensive as to the eventual outcome of every case.

Perhaps the most important element that enters into a satisfactory adjustment is with reference to the make-up as well as the characteristics of an adjuster.

It has been frequently stated that "an adjuster is born and not made" and I can heartily endorse this statement. I have known individuals well posted from every standpoint who were utterly unable to accomplish anything as fire loss adjusters.

Such individuals might be able to readily ascertain the amount of any loss probably with a greater degree of accuracy than their successful associates, though they were unable to so convince the insured. It is one thing, of course, to be able to ascertain a loss as well as to construe a policy contract, but it is an entirely different thing to be able to convince others of the properness of one's line of reasoning.

From time immemorial the general public has looked upon the adjuster as the "bull dog" type of individual, though from my observation the most successful men in the profession are those who have a thoroughly pleasing and inoffensive demeanor as well as diplomacy.

As a rule the average individual suffers not more than one loss during a lifetime, and naturally when this crisis arises, diplomacy as well as consideration on the part of the company adjuster accomplishes more to straighten out misunderstandings than any other form of treatment.

The policy contract becomes a thoroughly personal one at this time. The insured when purchasing the policy does so purely from the standpoint of protection in the event of a casualty and in probably not one out of ten thousand cases is the contract carefully read and considered. Naturally after a loss the insured reads the policy from beginning to end and no doubt notices that there are several things which should have been done which he has failed to do. He is, as a rule, somewhat excited or over-wrought upon the arrival of the adjuster, and unless the latter's attitude is considerate and

reasonable a serious and thorough misunderstanding may arise.

As a general rule no insurance adjuster is delegated with the authority to waive a policy violation, his duty being to ascertain the facts and, if possible, agree upon the amount of the loss. If one or more essential condition of the policy has been violated, the adjuster usually submits a written report to the company, and upon receipt of definite instructions either denies liability, attempts a compromise settlement, if same would seem to be in order, or submits a blank proof of loss to the insured for signature on basis of the agreed loss.

As previously stated, few companies endeavor to take advantage of minor technicalities which frequently arise, and particularly where there has been no wrong intent.

It is only natural that the adjusting or loss department of any insurance company can be no more human than its executive heads, though from my observation it is my candid opinion that more considerate treatment is accorded by fire insurance companies in the adjustment of losses than in any other similar branch of commercial enterprise.

Perhaps an item of general interest would be the consideration of those claims properly coming within the category of fraudulent losses.

Insurance companies while most considerate of an honest and deserving claimant, are as a rule the reverse when confronted with a fraudulent claim, though unfortunately, due in great part to our form of judicial procedure, fraudulent claims are either collected direct from the company by reason of ignorance of the latter as to the existence of fraud, or through the channel of the courts.

It is seldom indeed that an insurance company will withstand suit unless a positive as well as a good defense exists.

It has always been the writer's theory that a fraudulent claim will at some stage of the adjustment or investigation be easily detected. It is very seldom that the individual who has deliberately burned his property will not leave uncovered some vital fact or feature which will, when discovered, place the loss within the proper category. For instance, I recall one distinct case where a very beautiful set of books had been presented to the adjuster by the insured to substantiate his claim for loss of a stock of merchandise, and the adjuster when casually examining the last detailed inventory suddenly detected the fact that one page of the inventory was dated a year ahead of the date of loss. This of course is contrary to all rules of human nature. One will frequently in the first part of a year insert a date through error or from habit, as the past year, yet I do not know of any individual who has ever through error or habit inserted a coming year as the date upon which an instrument or document was drawn up.

Perhaps one of the greatest assets or qualities for an adjuster to have is a thorough knowledge of human nature. Those company representatives who proceed upon the theory that all losses are questionable, seldom, if ever, are elevated to important positions by the company. On the other hand the adjuster who considers every one honest is not only a costly investment for his company, but he is in addition a menace to society by reason of the fact that "loose" adjustments are unquestionably responsible for additional or further losses.

Perhaps if our laws were a little more stringent with respect to responsibility in connection with the cause of a fire, insurance companies would be able to afford the necessary protection for a much more reasonable rate of premium than at present. In France, I believe, as well as in some other foreign countries, every fire is properly chargeable to the negligence of some individual. For instance, where a loss occurs the proprietor or occupant is usually placed under arrest until he establishes his innocence both with respect to fraud as well as undue carelessness. If the loss is due say to a structural defect of the building, the contractor or builder is next interrogated by the authorities, and he in turn may be able to demonstrate that the building was erected in strict accordance with the plans and specifications. The next individual questioned is the architect who may be adjudged guilty of carelessness or improper judgment in connection with the origin of the fire.

The courts of this country, due to our system of legal procedure, have given the insurance companies as well as the public little assistance in connection with the segregation of fraudulent and accidental losses; apparently confining their verdicts wholly to the contract and not to the apparently true facts in the case.

Without going into a technical, or attempting a far reaching legal discussion of the conditions of the present New York Standard Policy, it will probably not be amiss to take up for consideration and briefly consider each essential condition.

In the foregoing the first provision of the policy—

> "does insure John Doe and legal representative, to the extent of the actual cash value, etc."

was quoted in full, and following this appears

> "against all DIRECT LOSS AND DAMAGE BY FIRE and by removal from premises endangered by fire, except as herein provided, to an amount not exceeding .... Dollars to the following described property while located and contained as described herein, or pro rata for five days at each proper place to which any of the property shall necessarily be removed for preservation from fire, but not elsewhere, to wit: as per printed form attached, duplicate of which is filed in this office."

Following this provision a printed form is usually attached to the policy briefly describing the character of the property insured, that is, whether it consists of a building, household furniture, stock of merchandise or any other real or personal property. The location or locations at which the property is situate are then inserted in the form and afterward all clauses or permits, such as co-insurance, lightning, electricity, etc., are inserted.

Any permit or clause attached to the form necessarily takes precedence over any contrary provision in the policy—see lines 72 to 77 reading:

> "The extent of the application of insurance under this policy and of contribution to be made by this Company in case of loss or damage, and any other agreement not inconsistent with or a waiver of any of the conditions or provisions of this policy, may be provided for by agreement in writing added hereto."

Though particular attention is called to the fact that the foregoing is only true provided the permits or added agreements are not inconsistent with or a waiver of any conditions or provisions of this policy.

The body of the policy, lines 1 to 200, begins:

> "This entire policy shall be void if the insured has concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof; or in case of any fraud or false swearing by the insured touching any matter relating to this insurance or the subject thereof, whether before or after a loss."

The meaning of the foregoing is that the policy shall be void in the event the insured has deliberately concealed or misrepresented any material fact or circumstance. For instance, in securing insurance the insured may make a direct statement as to the cost of the property to him, as well as the age and condition of the property, whereas upon investigation it develops that an entirely different situation exists. As I have already said, what an individual pays for an article or piece of real property is not necessarily a guide as to its value at the time of any loss, though where a deliberate misstatement is made of any material fact or circumstance, it will unquestionably be held to void the policy. For instance, the insured may, in securing a certain policy, maintain that he has no other insurance and the company's agent in granting insurance may do so with the distinct understanding that there is no additional insurance. The policy, it is true, would be void by reason of other insurance without notice, though misrepresentation on the part of the insured would be as vital a defense as this added condition.

In addition to the feature of misrepresentation, the act of the insured in giving false testimony following a loss will be equally effective in voiding the policy.

Under the head of "Requirements in Case of Loss," the company's right to examine the insured under oath was touched upon, and it may therefore be said that when during such examination the insured gives false testimony, he may by such act create a voidance of the policy, whereas the instrument may at the time of the fire exist as a valid contract.

Lines 7 to 11 inclusive state:

> "This policy shall not cover accounts, bills, currency, deeds, evidences of debt, money, notes or securities; nor, unless specifically named hereon in writing, bullion, manuscripts, mechanical drawings, dies or patterns."

The foregoing condition hardly needs a detailed explanation other than to state that while bullion, manuscripts, mechanical drawings, dies or patterns may be and are frequently covered under the policy by specific endorsement, yet never in any instance are accounts, bills, currency, deeds, evidences of debt, money, notes or securities covered other than for their cost to replace. In other words the amount of a debt cannot be covered except under a very peculiar form of agreement, not however, attached to the standard policy, though probably by some such institution as London Lloyds, even though the bill or document intended to be covered under the policy may be the only true evidence of the debt. Deeds are frequently covered though only for the cost to replace, that is, the actual clerical work incidental to duplication. No doubt fire insurance is frequently carried on money, notes and securities, though not, I am quite sure, under the standard policy.

The policy proceeds—see lines 12 to 19 inclusive:

> "This Company shall not be liable for loss or damage caused directly or indirectly by invasion, insurrection, riot, civil war or commotion, or military or usurped power, or by order of any civil authority; or by theft; or by neglect of the insured to use all reasonable means to save and preserve the property at and after a fire or when the property is endangered by fire in neighboring premises."

We have had during the present world war a very clear example of the application of the foregoing, and particularly with reference to what has been defined as a riot by the statutes of various states. The Statute of New York declares that the act of three or more persons may constitute a riot, and therefore the destruction of property by fire as a result may be said not to be covered under the policy.

During the progress of a big fire it may happen that the civil authorities will cause the destruction of property by dynamite or fire in order to stop the spread of the fire, and naturally the property owners so affected make claim under a fire policy. This, however, is not a legal claim under the contract, and where it can be demonstrated that property involved was damaged or destroyed by dynamite or fire by order of the civil authorities, there can be no collectible loss under the policy.

The theft of any portion of property involved during a fire is not a loss coming under the terms or conditions of the policy.

The last portion of the above quoted provision is seldom enforced by the company due to the fact that it is, as a rule, very difficult to demonstrate to the satisfaction of a jury that all reasonable means to save and preserve the property have not been used. For instance, I know of several cases where a storekeeper has deliberately prevented the removal of a stock, due to his idea that the fire would not reach his premises, as he no doubt felt, and possibly very properly so, that a removal of the property by the general public would cause greater damage than the risk involved would warrant in allowing the property to remain at its present location. Of course, where it could be demonstrated that an insured had every opportunity of removing the property and deliberately failed to do so, the company could unquestionably avoid payment of the loss.

Lines 20 to 31 inclusive state:

> "This entire policy shall be void, unless otherwise provided by agreement in writing added hereto,
>
> (a) if the interest of the insured be other than unconditional and sole ownership; or (b) if the subject of insurance be a building on ground not owned by the insured in fee simple; or (c) if, with the knowledge of the insured, foreclosure proceedings be commenced or notice given of sale of any property insured hereunder by reason of any mortgage or trust deed; or (d) if any change, other than by the death of an insured, take place in the interest, title or possession of the subject of insurance (except change of occupants without increase of hazard); or (e) if this policy be assigned before a loss."

As you will recall, in the foregoing stress was laid upon the fact that fire insurance under the standard policy covers an interest and not simply a physical piece of property, as in the marine contract, and therefore the interest of the insured in the property described must be clearly set forth in the policy or same may be said to be null and void. For instance, if insurance should be granted to an individual who had say a half interest in either a piece of real or personal property and this fact was not noted in the policy, the contract would be null and void as to any loss which might be sustained.

A building situate on leased ground, where this fact is not noted in the policy, could not be said to be covered, nor would the insured be able to collect any loss under the standard policy.

If the insured permitted foreclosure proceedings without notifying the company, or permitted a notice to be given of sale of any property covered under the policy by reason of any mortgage or trust deed, the policy would be void from date of such occurrence.

If, following the issuance of a policy, the insured should die, it is unnecessary to secure an endorsement as the policy is valid as to the estate or heirs until expiration, though when renewed should be in name of the estate or the heirs.

Where a building as described is occupied as a store or blacksmith shop, any change of occupancy may occur unless the entire nature of the business is changed, that is, if a dry goods store were converted into a powder factory without notice to the company, the policy would be void from date of change of the occupancy. The owner and occupant of a blacksmith shop may in turn rent the premises to another individual who will likewise operate a blacksmith shop, but this would not be contrary to the policy provisions.

Fire Loss Settlements

THIRD LECTURE

BY

J. T. DARGAN, Jr.
Assistant General Adjuster

THE HOME INSURANCE COMPANY
NEW YORK

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Fire Loss Settlements

Third Lecture

The subrogation provision of the present New York standard policy, lines 197 to 200 inclusive, reading:

> "This Company may require from the insured an assignment of all right of recovery against any party for loss or damage to the extent that payment therefor is made by this company."

is quite different from this provision in the old policy. The request has been made that the rights of the company under this provision of the policy be defined. The main difference between the subrogation provision in the old New York standard policy and the new is that in the latter it is stated that:

> "This company *may* require............................"

whereas in the former it is stated that:

> "This Company *shall* on payment of a loss be subrogated."

In the old form there was no provision whereby the company could upon request obtain a mere assignment to the extent of its payment, unless it was alleged that the fire was caused by the act or neglect of a person or corporation. It is quite true that the right of subrogation accrues as a result of common law, provided, of course, the company is clearly legally entitled to succeed to the rights of the insured against the third person.

I believe that there is a decision in one state which forces the company upon payment of a loss to make specific demand for the execution of a subrogation receipt or assignment, though in the absence of any such decision, the right

of subrogation would, I believe, exist regardless of whether the company did or did not at the time of loss obtain a subrogation receipt. There would seem to be a distinction between a subrogation receipt and a mere assignment; the first being the legal operation by which the company in paying the insured succeeds to the rights of the insured against the person or corporation whose negligence caused the fire, whereas in the case of an assignment, the company would have the privilege of insisting upon the execution of an assignment in its favor upon making payment of loss to the insured, and it would not be necessary in obtaining such assignment to make any allegation as to the cause of the fire.

The company, when making payment of a loss which has been caused by the negligence of a third person, invariably requires the execution on the part of the insured of a subrogation receipt or assignment.

The company in filing suit against the person or corporation, whose negligence caused the fire, may sue in its own name as assignee, or suit may be entered in the name of the insured, though, if the latter procedure be adopted, the insured's consent and acquiescence must of course be secured.

Where the loss sustained exceeds the amount of insurance collected, the insured would seem to have an equitable right to participate in the proceeds of the amount recovered, if any, and in a large percentage of cases suit is brought in name of the insured with a side agreement whereby it is stipulated that the company and the insured shall participate in the net recovery in accordance with the amounts of their respective interests.

I do not believe the company has the legal right to act without reasonable regard for the interest of the insured. In other words, if the insured sustained a loss far in excess of the insurance, the company could not, even though it had obtained the necessary subrogation receipt or assignment, enter into a compromise settlement of the claim with the third person ignoring the unsatisfied interest of the insured in the settlement, unless perchance the subrogation receipt or assignment, by its terms and conditions, gave the company the legal right to do this.

No company, however, will as a rule attempt to proceed under a subrogation receipt or assignment without first reaching some agreement with the insured concerning the participation of his interest in either a compromise settlement or recovery by suit.

The subrogation provision in the old policy necessitated the company alleging that the fire was caused by the act or neglect of some person or corporation, whereas the provision in the new policy does not mention this feature.

Unquestionably the benefits, therefore, of the subrogation provision in the new policy are far superior to those afforded in the old.

Embodied in the New York and New Jersey standard mortgage clause is the following subrogation provision:

> "Whenever this Company shall pay the mortgagee (or trustee) any sum for loss or damage under this Policy and shall claim that, as to the Mortgagor or owner, no liability therefor existed, this Company shall, to the extent of such payment, be thereupon legally subrogated to all the rights of the party to whom such payment shall be made, under all securities held as collateral to the mortgage debt, or may at its option, pay to the mortgagee (or trustee) the whole principal due or to grow due on the mortgage with interest, and shall thereupon receive a full assignment and transfer of the mortgage and all such other securities; but no subrogation shall impair the right of the mortgagee (or trustee) to recover the full amount of his claim."

By the foregoing is meant that the company merely steps into the shoes of the mortgagee, or in other words either buys the mortgage outright, if the amount paid equals the face of the mortgage, or if less than the mortgage, then the company simply acquires an interest in the mortgage to the extent of the amount paid.

As the mortgagee under the standard mortgage clause frequently has distinct advantages over the insured, it occasionally becomes necessary or advantageous for the company to pay off the mortgage in full, even though it is often necessary to pay or advance more than the amount of the policy.

The company may be liable to the mortgagee but not to the insured, and by paying the full amount of the mortgage and obtaining an assignment thereof, the company may then proceed to insist upon the payment to it by the insured of the full amount of the mortgage, and upon the insured's failing to comply the company has the right, when the mortgage becomes due, to foreclose upon the property and obtain exactly the same benefits as would have been obtained by the mortgagee in the event that no insurance had been collected. It is true that if no fire had occurred, the mortgagee would have had the added value of the improvements as security for the payment of the debt, and therefore the company, when acting as the assignee, as a rule only obtains the benefit derived from the sale of the vacant land.

In those instances where the company pays the mortgagee an amount less than the mortgage and acquires an interest in the mortgage to the extent of its payment, it—the company—cannot take any action that would adversely affect the interest of the mortgagee; in fact the remaining amount due the mortgagee must first be paid before the company has the right to participate in the proceeds derived from the sale of the property.

In the adjustment of losses on property situate on the railroad right of way, the adjuster is frequently confronted with the situation where a waiver of the property owner's rights with respect to the liability of the railroad has been

made in consideration of the act of the railroad company in laying a spur track up to and frequently upon the insured's premises. Where the insured has previous to the date of the policy signed an agreement relieving the railroad company of all responsibility for loss caused by negligence or otherwise the question arises whether the policy has ever existed as a valid contract. Where no change has taken place during the life of the policy, it is seldom indeed that the company attempts to take advantage of the situation with respect to the adjustment of the loss with the insured. Where, however, the insured has during the life of the policy signed an agreement relieving the railroad of all responsibility, thereby incidentally waiving any and all rights which the company may have, it would seem that a valid defense exists as to the payment of any loss.

The insured, however, as a rule, never considers the effect of waiving his rights against the railroad company as concerning the fire insurance contract.

Where the common carrier or railroad company happens to be the cause of fire which damaged property in cars on a railroad siding on the insured's premises, where the shippers had not waived any of their rights, the latter would unquestionably be able to collect the full amount of their loss from the railroad company, or if the insurance company had paid the insured the full amount of the loss, then the doctrine of subrogation would apply and the company could in turn collect the full amount of the loss, which it had paid to the insured, from the railroad company.

Where it could be proven that the fire was due to negligence on the part of the property owner, the railroad company could unquestionably succeed in collecting the loss or damage to its property on the siding, provided no agreement to the contrary existed. And again the railroad company could collect for the loss or damage to property on its main line, provided negligence on the part of the property owner could be proven.

A great many recent forms presented to the underwriter, under which some losses have been sustained, are we notice designed to cover the liability of the property owner to the railroad company for cars of the latter in the former's possession or on the former's premises.

The consequential loss and damage clause, when contained in the policy, is simply an added condition which places the necessity upon the company of recognizing liability and paying for loss or damage sustained by the insured on property which may not in the slightest degree from a physical standpoint actually be damaged by fire or water. To illustrate, the refrigerating machinery of a cold storage plant may be situate in a building some distance from the storage warehouse. A fire in the machinery building may put the refrigerating apparatus or plant entirely out of business and it may

be physically impossible to make necessary repairs within sufficient time to save and preserve stock in the warehouse, such as meats. It could not be said, of course, that the stock of meats had in the slightest degree been damaged by fire or water, and therefore the consequential loss and damage clause was designed to cover this situation, and the insured holding a policy in which the consequential damage clause is contained would, in the case just cited, be able to collect the entire loss or damage sustained on meats, whereas had there been no consequential loss or damage clause in the policy, no loss could have been collected by the insured on meats notwithstanding the fact that the stock in question had proven to be a total loss.

Most of the consequential loss and damage clauses contain a provision that the insured shall use due diligence to repair, or restore, the damaged or destroyed building, or buildings or plant, and therefore when it could be proven that the insured had not acted with due diligence in an endeavor to save and preserve the property affected, the company could naturally sustain a denial of liability.

In a large percentage of the consequential damage clauses a further provision is embodied, that the insured shall give the company immediate notice, and the importance of compliance with this provision can be very readily understood.

Bearing in mind that a fire policy is intended to cover only ALL direct loss and damage by fire, the question frequently presents itself as to what may constitute a direct loss and damage by fire.

One of the simplest illustrations is with reference to loss or damage by explosion, preceded of course by a fire. The overwhelming trend of court decisions with reference to this feature is that the company is liable under the regular fire policy for ALL loss or damage where it can be proven to the satisfaction of the jury that the proximate cause was a "hostile" fire. On the other hand, where the company can produce evidence that a "friendly" fire preceded the explosion, the only liability which may accrue under the policy is the damage which may be sustained by the ensuing fire, that is the fire which may follow the explosion. It is, of course, frequently quite difficult to separate the fire and explosion damage, though this is a matter of agreement as to amount and is not a question of contract.

By "proximate" cause is meant the nearest cause. That is, the cause to which the loss is most nearly related.

Of all forms of insurance at present accepted or written probably no form is so little understood as Use and Occupancy, and it is the adjustment of this type of loss that gives the present day adjuster the greatest amount of thought as well as hard work. Unfortunately forms designed to cover use and occupancy are by no means uniform, and it is therefore impossible to lay down a set rule as to the proper pro-

cedure in event of a loss other than to say that the adjuster frequently has to secure the real intent of the parties at interest over and above the actual contract.

Many features enter into the adjustment of a use and occupancy loss upon which even no two competent adjusters agree.

It is true that the ascertainment of the actual loss sustained on net profits of the business does not appear to be a difficult problem, though where the plant or concern sustaining the loss is a large or complex one, I believe I am safe in saying that I do not think any two competent adjusters could achieve exactly the same result in independently figuring on the actual loss sustained of net profits, from exactly the same records.

In addition to the actual loss sustained of net profits on the business which may be prevented by the fire, the item of fixed charges and expenses as must necessarily continue during a total or partial suspension of business is frequently covered, though the determination of just what may be said to constitute fixed charges and expenses is another problem for the adjuster.

The entire use and occupancy cover is naturally predicated upon the item of time required to rebuild, repair or replace the property damaged or destroyed, and the item of time in this instance is, of course, figured from the date of the fire and not from the date of the arrival of the adjuster nor of the completion of the adjustment nor of the payment of the loss.

A great majority of use and occupancy forms embody a provision limiting the liability of the company to not exceeding $.................... for each business day of such suspension, though this is not intended for, nor does it have the effect of a valued policy as many brokers seem to feel.

The most essential fact for an adjuster to consider in the adjustment of a use and occupancy loss is that the contract is intended to indemnify the insured against actual loss sustained plus the item of fixed charges and expenses, if covered, and bearing in mind the intent of the cover, the only proper method to pursue is, as stated, first to ascertain the true intent of the parties at interest as concerning the item of fixed charges and expenses and then by a keen analysis of the insured's books and records to ascertain the percentage of profit.

I personally know of one loss coming under this head where the insured, upon being able to realize the same, or in fact in that instance a greater profit, first reported a loss under his use and occupancy policy, but subsequently of his own volition withdrew same as he reached the conclusion that he had sustained no loss coming under the terms and conditions of the contract, though of course in that instance the form did not contain the provision covering fixed charges and expenses.

Many use and occupancy forms contain a provision that a certain previous stated period, varying from six to twelve months, shall be utilized in ascertaining the average profit earned, and others are entirely silent on this feature.

The adjustment of use and occupancy losses presents most difficult problems while business conditions are unsettled as at the present time. To illustrate, a merchant or manufacturer may be able to show an unusual profit for the last preceding six or twelve months, whereas the same concern may now be doing business at a loss. The use and occupancy form, therefore, must first be analyzed before an expression of opinion can be given as to the company's liability. In those instances where the merchant is now doing business at a loss, the only collectible item under the policy is with reference to fixed charges and expenses, provided of course the cover could not be said to be a valued one.

A question several times presenting itself to us is with reference to the inclusion or the properness of excluding the cost of removing debris in the event of both a building as well as a personal property loss. In the event of a partial loss on the building, the item of removing the burned or damaged portion of the building together with the debris is invariably admitted as a part of the loss. Where, however, a total loss to the building structure has been sustained and by chance the amount of insurance slightly exceeds the agreed sound value of the building, then the question arises: Is the added cost of removing the debris a collectible item under the policy? There are no court decisions on this point so far as I know, and it is hard for me to believe, even taking into consideration the trend of court decisions, which lean toward the interest of the insured rather than the company, that the latter would be called upon to pay any sum in excess of the entire sound value of the building. The item of cost of removing the debris may be covered under the policy, but it should be clearly stated.

In the event of loss of personal property, such as a stock of merchandise or any property other than a building structure, the cost of removing the debris does not so frequently arise, though in one recent instance the question was propounded to us whether in the event of the company's admitting a total loss to sound value, could the insured insist upon the payment of the additional amount necessary to remove the debris—the amount of insurance being in excess of the agreed sound value. I believe, as stated, that the company's liability is limited by the sound value, and I cannot conceive of any situation which might arise where the insurer could be called upon to pay exceeding the value at the time of the loss, provided, of course, the policy contained no contrary or added provision. I have heard some doubt expressed on the part of some adjusters as to the legal right of the company to exclude the item of the cost of removing the debris in the

event of a total loss on a building structure, but, as stated, there are no decisions on this point of which I have any knowledge, and I am quite sure that no company would be willing to admit this item other than on a strictly compromise basis.

The question frequently arises as to the proper course to pursue in making a denial of liability on behalf of the company. The writer's custom, or belief, in this respect is that it is not necessary to insert in a letter denying liability any cause or reason, but a mere statement, setting forth that the insurance company hereby informs you that it denies any and all liability as a result of claim made on account of fire on such and such a date, should suffice.

Where the premium has been paid in advance and the policy is void from issue, I believe the safest policy to pursue is to tender the full return premium together with the legal rate of interest from the date premium was received. A majority of attorneys seem to feel that this is unnecessary, though certainly no harm is done and opposing counsel are prevented from dwelling upon the acceptance of and failure to return premium.

In those cases where the insured has through some act voided the policy since the date of issuance, I do not believe it is necessary to tender any return premium, for the policy did at time of issuance exist as a valid contract, and it so existed for a period thereafter, and naturally had a loss occurred during such time the company would have been called upon to fulfill its contract by paying the proper amount due.

The co-insurance, or reduced rate contribution or average clause, is a provision added to the policy, designed to force the insured to carry insurance up to a certain stated value, and failing so to do, the insured must bear his proportion of the loss.

The simplest manner in which the co-insurance clause can be applied is by considering that the insured will in every given case be entitled to collect a certain fractional portion of the loss; the amount of insurance actually carried being the numerator of the fraction and the amount of insurance which should have been carried being the denominator. To illustrate, if a building should be valued at $10,000, the insured would, under the 80% co-insurance clause, be required to carry $8,000. If, however, in the event of a loss the insured had only provided for $6,000 insurance, then he would be able to collect only 6000/8000 or ¾ of any loss. Upon applying this very simple formula it will readily be seen that when a loss amounts to or exceeds the percentage named in the co-insurance clause, the insured will succeed in collecting all insurance, though of course there will be a deficit in that he will be forced to stand the loss sustained over and above the amount of insurance up to, of course, the true extent of the loss.

Many adjusters, and particularly beginners, are confused as to the proper method of applying the distribution average clause together with the co-insurance clause. As stated, the co-insurance clause is designed to force the insured to carry a certain percentage of insurance to value, whereas the distribution average clause is a condition of the policy, which, when added, distributes the insurance at the several locations named in the proportion that the value of the property covered at each location bears to the value of all the property. To illustrate, let us consider a $100,000 policy, covering three retail lumber yards designated as numbers 1, 2 and 3, with the 80% co-insurance clause applying. The fixed value of the lumber stored at yard No. 1 is $50,000, the value upon yard No. 2, $50,000, and the value upon yard No. 3, $100,000. Under the distribution average clause the $100,000 insurance will be apportioned 50000/200000 or ¼, i. e. $25,000, covering yard No. 1; 50000/200000 or ¼, i. e. $25,000, on yard No. 2, and 100000/200000 or ½, i. e. $50,000, on yard No. 3.

It can be readily seen that the insured is short insurance at all locations, and therefore in the event of loss must bear his ratable proportion by application of the co-insurance clause as above explained. A rule which all adjusters should remember is that the distribution average clause must first be applied prior to operation of the co-insurance clause.

The three-quarter value clause is a condition of the policy which, when added, is designed to prevent over insurance and is, therefore, in direct contrast to the co-insurance clause.

Under the three-quarter value clause the insured cannot under any condition, regardless of the amount of insurance carried, succeed in collecting more than three-fourths of the value of the property covered at time of any loss. This statement, however, must be made with the reservation that in certain states the three-quarter value clause has by law been made inoperative, and even though it may be inserted in the policy by the company without penalty, yet if the insured objects it cannot be applied, and must, therefore, be ignored by a company representative in the adjustment.

In several states insurance companies are forced to contend with what is known as a valued policy law; said law having reference only to insurance on building structures. The law as a rule requires the insurance company to state in the policy the agreed value of the building, and by this provision the company is estopped from raising any question as to the stated value in the event of a loss, barring, of course, the question of fraud which may be utilized as a defense under any contract and under any condition.

Unfortunately the valued policy law permits numerous abuses, one of which being the impossibility of properly applying the co-insurance clause where the building has in the policy been valued at a ridiculously low figure. While this law is not in any respect favorable to the interests of the

company, and it was never designed to be, yet it has in many cases acted as a boomerang. For instance, the insured may have deliberately valued his property at a very low figure in one policy, which policy carries provision for other insurance and contains a co-insurance clause, whereas it is ascertained at the time of the loss that the insured has procured insurance greatly in excess of the fixed stated value. The valued policy laws in force at present in several states do not permit the collection of an amount exceeding the stated value, and it is, therefore, useless for an insured to carry insurance in excess of the value as set forth in the policy or policies.

A very troublesome situation which frequently arises is with reference to what may be construed as double insurance on improvements or betterments to a building structure. In a large percentage of the cases, barring an agreement to the contrary, all improvements and betterments made upon or in a building structure by a tenant instantly become the property of the owner, and the tenant cannot remove the improvements or betterments upon expiration of the lease, nor can he deface the building in an endeavor to place it in the same condition it was in upon commencement of the lease.

The value of improvements and betterments is predicated to a large extent upon the life of a lease, and therefore the insurable interest of the tenant investing money in improving or bettering the building is a very clear and well-defined one. On the other hand the landlord or owner invariably carries building insurance, and it is seldom, when a loss occurs in such a building, that the question does not arise as to which class of insurance shall pay the loss and, if both, upon what basis. The tenant carrying insurance on his improvements and betterments is certainly entitled to a full measure of protection and the company covering the building structure cannot sustain a denial of liability for loss on improvements and betterments in the event the owner persists in making a claim for same.

Most losses of this type are settled upon a compromise basis, that is by an agreement between all interests. If, however, it is impossible to secure concurrent action, the only method by which duplication of payment of either all or any part of the loss can be avoided is by actual repairs being undertaken by the companies interested, both on the building as well as the improvement and betterment line, under a side agreement, the eventual basis of settlement between themselves having previously been agreed upon.

Probably one of the most frequent situations which arises in the adjustment of losses on household furniture is with reference to the existence of a chattel mortgage covering the property described either in whole or in part. A large percentage of those individuals who purchase pianos or victrolas, do so on the partial payment plan, and upon making the first payment a contract of sale is invariably required by the

seller, which contract the purchaser usually signs without reading. Most of these contracts are designed to retain the title in the name of the seller until the final payment is made, though I am very much inclined to believe that the legal title would, in the event of litigation, be proven to be vested in the purchaser; the interest of the seller being that of a mortgagee or lienor. Regardless of whether the title could be said to be vested in the purchaser or seller, a voidance of the policy with respect to the item involved could be said to exist. The policy, as you know, requires sole and unconditional ownership and further provides that personal property covered shall not be encumbered by a mortgage.

If, therefore, in presenting a claim upon the company, the insured should incorporate in the schedule the item which is being purchased under contract, and has not been paid for, the entire claim could be rejected by the company and the insured could not succeed in collecting anything by a suit. If on the other hand the insured made no claim upon the item in controversy, the company could not disclaim liability on the remaining property which was not covered under a chattel mortgage.

In several states there are very peculiar laws with respect to the sale of real property under contract. In Florida, for instance, the execution of a contract of sale, where the payment say of only $1 had been made, vests the legal title in the purchaser under contract; the seller occupying merely the position of a mortgagee, and a mortgage on real property in but very few states affects the validity of the policy.

11

Apportionment of Losses
Under
Nonconcurrent Policies

A LECTURE

BY

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NEW YORK

Apportionment of Losses Under Nonconcurrent Policies

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The Home Insurance Company

This subject has been one of absorbing and ever increasing interest ever since the contribution clause came into general use as a policy condition and even before. It has commanded the attention of the courts as well as that of the best legal and lay minds in the fire insurance business for nearly a century, and although many rules have been devised for the apportionment of losses where policies are nonconcurrent, no rule of universal or even general application has been found and the prospect of discovering the philosopher's stone is as remote as ever.

What is the "whole insurance" upon the property covered, or on the items damaged, when both specific and general policies are involved? Shall the blanket policy contribute with one specific policy and in remainder with another and so on all down the line, or shall it be distributed on the various classes in the ratio of value, the ratio of loss, or in some other manner? What effect should the presence of a co-insurance or average clause in one or more nonconcurrent policies have upon the apportionment? No satisfactory answer to these questions has ever been given.

All the courts which have passed upon the question have held that the first requisite of any method of apportionment must be the insured's protection to the full extent of his rights under his policies and any method, which in a given case fails to afford him this just measure of indemnity, must give place to another that will.

This is eminently proper, because other insurance is taken out by the insured for his own benefit and not for the benefit of co-insuring companies. He pays the premium and consequently it is his interest which should be the prime consideration. The benefit accruing to co-insuring companies is and should be regarded as a piece of good fortune and merely incidental; but as each policy is an independent contract, it should be construed in the light of reason without doing violence to any of its provisions.

Almost all of the well known rules of apportionment were devised long before that evolutionary product of the insurance business—co-insurance—made its appearance, and although some of them served reasonably well in many

instances as means to an end, the question has been so affected by co-insurance conditions that all the older rules have in a large measure lost what merit they possessed as practical working propositions.

As it has seemingly been impossible to find any rule of apportionment of general application, it follows that it would be equally impossible to prepare a contribution clause which would satisfactorily meet all conditions, hence the present brief form, in view of the general inclination of the courts to construe it along reasonable and equitable lines, is probably as good as can be devised, except that possibly some amendment might be made in order to meet situations growing out of co-insurance or reduced rate average clause conditions.

Simple Nonconcurrence

In cases of simple nonconcurrence, the law is apparently settled. Where there is a loss on one item only, the full amount of the blanket or general policy must contribute with the specific toward the payment of the loss. Page Bros. vs. Sun Ins. Office, 74 Fed. 203, 20 C. C. A. 397. In that case the court used this somewhat striking sentence, "This contract is too plain to permit construction, too positive to allow evasion, and too clear to admit of doubt."

When there is a loss on two items, one of which is covered by a specific policy, and there is also a blanket policy covering both, the latter must first pay the loss on the extraneous item and then contribute in remainder with the specific. Cromie vs. Kentucky and Louisville Ins. Co., 15 B. Mon. 432 (Ky. 1854).

To the minds of some, both these rules place too great a burden upon the blanket policy, but the argument of the court in the Page Bros. case (supra) in support of the first, emphasized as it is by the decision of the Court of Appeals of New York in the case of Farmers' Feed Company vs. Scottish Union & National Insurance Company, 173 N. Y. 241, and the Supreme Court of Wisconsin in the case of Stephenson vs. Agricultural Insurance Company, 116 Wis. 277, 93 N. W. 19, both of which decisions, singularly enough, were rendered the same day, seems to be unanswerable.

The second rule has not received universal endorsement. If, say its critics, it be admitted that there must be some division of the blanket policy, the question might easily arise whether that division should be made by setting aside as covering on the extraneous item an amount just sufficient to pay the loss thereon, and apply the remainder to contribute with the specific policy as in the Cromie case (supra), or whether some other division might not or should not be made. This thought seems to have been in the mind of Chief Justice Marshall, when in the Cromie case, he expressed grave doubt

whether, on account of the continuing liability of the blanket policy on the undestroyed property, and the possibility of a later loss thereon, the Court had not made that policy contribute with the specific for too great an amount. If he could have anticipated present-day co-insurance conditions, he would, through his seeming solicitude for the interest of the insured, doubtless have discovered another reason for a different subdivision of the blanket policy, for while the Cromie rule points an absolutely sure way of giving the insured the maximum indemnity to which he is entitled in every instance in the absence of co-insurance, yet it has exactly the opposite effect in many cases when co-insurance conditions prevail.

Although it is conceivable that the co-insurance necessities of the insured may have some influence upon future decisions in cases of compound nonconcurrence, good arguments can be advanced against their doing so in cases of simple nonconcurrence.

According to the plain reading of the contribution clause, the specific insurer is entitled to contribution from the full face of the general policy. The courts, however, declare that full contribution will not be accorded if there be a loss on an extraneous item, but hold that the loss thereon must first be cared for by the general policy. If, therefore, the specific insurer consents to a modification of the clear, unambiguous phraseology of the clause to the extent of permitting the general policy to first pay this extraneous loss, it meets the situation fairly, and cannot be deprived of contribution from the remainder, without doing unreasonable and inexcusable violence to the contribution provision.

When there is no loss on any other item, there is nothing to deduct from the blanket policy, and the specific is consequently entitled to contribution from its full face.

The Page Bros. decision (supra) is so fundamentally sound as to preclude discussion. The Cromie decision has stood the test for over sixty years and its underlying principle has never been successfully assailed or seriously questioned; hence, it is entitled to be regarded as a fixed rule, universally applicable in cases of simple nonconcurrence.

If these two decisions are fundamentally sound when the policies do not contain co-insurance or reduced rate average conditions, they are equally sound when such conditions are present. These conditions neither increase nor diminish the amount of the policies containing them, or in any way affect the "whole insurance" on the property; hence they should not be permitted to have any influence whatever upon the contribution clause, so long as it retains its present phraseology. Apportionments under them must, however, always be subject to the limit of liability of all policies under their conditions of co-insurance or average.

Such extraordinary liberties, however, have been taken with the contribution provision from the time of its birth, and it has been disfigured by the experts and the courts in such a variety of ways, as to leave one in doubt whether there is any limit to which they will not go in that direction, in order to meet the necessities of the insured. But when all is said, it would seem that the argument advanced by the court in the Farmers' Feed Co. case—that the insured should stand a portion of the loss himself in a certain contingency, because he virtually agrees to do so—should apply to cases of simple nonconcurrence as well as to those where the policies are concurrent.

Compound Nonconcurrence

It is in cases of compound or interlocking nonconcurrence where two or more subjects which are covered by specific policies are also embraced within the cover of blanket policies, or where they interlock, that the principal trouble arises.

Some adjusters entertain the view that in cases of nonconcurrence, simple or compound, when it is found that the sum of the co-insurance or average clause limits of the various insurers is less than the total loss, each company should pay the amount of its limit, and that no attempt at an apportionment should be made. And if the sum of the co-insurance or average clause limits exceeds the total loss, as they frequently do, there should be deducted from each maximum limit its pro rata proportion of the excess loss in order to arrive at the net liability of each group of policies.

This view is evidently based on the following line of reasoning: Rates at the present time are quite generally predicated upon the use of the 80, 90 or 100 percent average or co-insurance clause. The insurers, in effect if not in fact, say to the insured: "If you will carry insurance to the extent of 80, 90 or 100 percent of the value of the property, as the case may be, and thus give us the benefit of that contribution in the event of loss, we will be satisfied, provided, of course, you are not overpaid." In cases of compound nonconcurrence where all policies contain the average or co-insurance clause, and the same is operative in all, where the aggregate insurance equals or exceeds the required percentage of the aggregate value, the insured should be entitled to collect his loss up to, but not exceeding, the co-insurance limit of each. If average or co-insurance conditions are complied with, the insured will have done all that was contemplated either by himself or the insurers when the policies were issued, and each company should be content if the amount apportioned to it does not exceed its average or co-insurance limit.

It will be observed, however, that the theory or rule above outlined is virtually the same as apportioning the total loss on all items on the basis of the average or co-insurance limits, instead of the face of the policies, and is in direct conflict with the principle laid down in Farmers' Feed Company and Stephenson cases (supra). In considering this question, we must take the insurance contract, not as it might, could, or should be, but as it is; and the contribution clause therein, although it has been distorted almost beyond recognition, is entitled to at least a rational construction.

In the case of Buse vs. National Ben Franklin Insurance Company et al., 161 N. Y. Supp. 566 (1916), the Supreme Court of New York, Erie County, applied the above principle in the apportionment of the loss. The old New York Standard Policy under which this loss occurred, lines 98 to 100, contains the following stipulation:

"and the extent of the application of the insurance under this policy or of the contribution to be made by this company in case of loss, may be provided for by agreement or condition written hereon or attached or appended hereto,"

and the court evidently concluded that by reason of this provision the average clause superseded the contribution clause of the policy, the latter clause being omitted from the average clause. The court also seems to have ignored the decision in the Farmers' Feed Company case (supra), evidently distinguishing the two cases by reason of the fact that in the former the policies were nonconcurrent, while in the latter they were concurrent. The case was not appealed probably on account of the smallness of the amount involved, hence we do not know what views the Court of Appeals may entertain on the subject.

It should be stated that the Farmers' Feed Company case is also distinguishable from the Buse case from the fact that in the former a part of the insurance did not contain the average or co-insurance clause, whereas in the latter case all the insurance was subject to co-insurance conditions.

Many ingenious methods of apportionment have been suggested, among which may be mentioned the Finn-Griswold-Kinne rule, the Connecticut or Gradual Reduction rule, the Reading, the Albany, and the Rice rules, and the later inventions, the Morristown and Giesse rules (so named on account of the modesty of their authors), all of which have been weighed in the balances and found wanting.

Each of these rules has had its strong advocates and also its hostile critics. The number of court decisions bearing on the subject are comparatively few, and there is quite as great a diversity of opinion among the experts as there is among the courts; in fact, there has probably been no court decision rendered which did not have its inception in the mind of some insurance adjuster.

Probably the best and most exhaustive discussion of the subject which has ever appeared is that contained in a paper read by the late E. F. Rice, adjuster of the Aetna Insurance Company, before the Underwriters' Association of the Northwest, and published in the proceedings of that organization in 1880. He reviewed and carefully analyzed all the decisions and views of text writers and experts up to that time, and clearly demonstrated that none of the methods which had been devised were theoretically sound or universally applicable. He showed by concrete examples that under the then known rules of apportionment, which made a division of the blanket policy, if the amount of gross loss were increased, the liability of the blanket policy might be diminished, and he rightly argued that any rule which would admit of a really bright adjuster increasing his company's salvage by magnifying the loss must be fallacious in principle. Mr. Rice invented an ingenious rule of his own, to which reference will be made later, and evidently thought he had at last found something which would withstand the criticism which he had directed against the older theories, but alas, Mr. Rice's own rule succumbed to the same test. The Kinne rule had not at that time made its appearance, but being an offspring of the Finn rule, it cannot withstand the test applied by Mr. Rice any better than the others.

The Reading Rule

This, briefly stated, provides for a division of the blanket policy among the various items of property in the ratio of values, for purposes of contribution.

This rule was used by the Supreme Judicial Court of Massachusetts in 1858 in the case of Blake vs. Exchange Mutual Insurance Company, 12 Gray 265, and again by the same court in 1913 in the case of Taber vs. Continental Insurance Co. et al., Vol. 42, Insurance Law Journal, page 516, 213 Mass. 487. The same principle was also applied by the courts in New York and Vermont, Ogden vs. East River Insurance Company, 2 Insurance Law Journal 135, 50 N. Y. 388; Chandler vs. Insurance Company of North America, 70 Vt. 562, 41 Atl. 502. This rule will often fully reimburse the insured and do no real violence to the interest of any insurer, yet it will in many instances fail to give full indemnity, and unless modified by making the division only among the items involved in the loss, will work quite an injustice to the specific insurers.

The point most frequently urged against it, is that it imports into the blanket policy the average distribution clause, a condition which is foreign to it, thereby giving it a more favorable construction than it deserves, but a similar objection can be urged with equal propriety against all of the other rules which call for a division of the blanket policy, and if the division be made only among the items involved in the

loss, in the ratio of value, there would seem to be no logical reason why this method should be subjected to any greater criticism than the others.

This rule has had the endorsement of the courts of last resort, to which reference has been made (supra), but in the cases decided the interests of the insured were not adversely affected by its application. If conditions had been otherwise we can easily believe that the principle of the rule would have been rejected by these courts just as it has been by others.

The Modified Reading Rule

This rule divides the blanket policies among all classes of property, whether involved in the loss or not, so that when possible, and as nearly as possible the percentage of available insurance to value will be the same on each class as the percentage of total insurance to total value of all classes.

This differs from the original Reading rule in that it takes into consideration both value and insurance, and the relation of one to the other. Although it is not universally applicable, it will work reasonably well in a large number of cases when co-insurance conditions prevail.

The Albany Rule

This much criticized and many times rejected rule, which was inserted as a condition in some policies fifty years ago, provides that if the insured shall have other insurance which includes the premises or property described, and such policy or policies shall at any time or under any circumstances or contingency be liable to the insured for any amount whatever, such policy or policies, as between the insured and the company, shall be considered as contributing insurance.

This condition was adopted because of the decision of the Court of Appeals of New York in the case of Howard vs. Scribner, in 1843, 5 Hill 298, wherein it was held that where there is both specific and blanket insurance the latter does not constitute "other insurance" and that the specific policy must pay in full without regard to the blanket policy. But this decision was overruled in 1872 in the case of Ogden vs. East River Insurance Company (supra). Strange as it may seem this antiquated doctrine still obtains in Pennsylvania, Meigs vs. Insurance Company of North America, 205 Pa. St. 378, 54 Atl. 1053. The Federal Court held to a contrary doctrine in another case (the Hill school case) growing out of the same fire, Meigs vs. London Assurance Company, 126 Fed. 781.

The Pennsylvania Court has certainly turned the tables on those who are imbued with the idea that no rule of apportionment is too good for the insured and the specific insurers, and none too harsh for the blanket policy. It swings the pendulum too far in the opposite direction, carries the doctrine of the conservation of the blanket policy beyond

all reason, and entirely ignores the contribution clause in the specific policies. The Pennsylvania Court had rendered a similar decision in the case of Sloat vs. Royal Insurance Company, 49 Pa. St. 14, in 1865, and its adherence to the same doctrine fifty years later indicates that the Court is still joined to its idols. The position of the Pennsylvania Court is unsound, and it is not at all surprising that its opinion is never followed by other states and is ignored in practice within its own borders.

The Albany rule very frequently entails a loss upon the insured and does a flagrant injustice to the blanket policy. It has been in harmless disuse for many years, and no one in these days gives it serious consideration.

The courts, however, in the Farmers' Feed Company and Stephenson cases (supra) when construing the words "whole insurance" held that the amount of insurance is the largest sum that the company in any circumstances, according to the terms of the policy, can be required to pay and not the smaller sum which can be collected under special conditions, and according to these decisions the loss which accrues to the insured by reason of the co-insurance or reduced rate average clause in certain policies must be borne by him and cannot be transferred to the companies whose policies are otherwise concurrent but have no such clause.

Although the language used in these decisions is exceedingly broad, and notwithstanding the fact that both courts permitted the insured to suffer a loss under special conditions in the face of the fact that they carried full insurance, it is hardly to be supposed that they would stand for the principle of the Albany rule in a case of either simple or compound nonconcurrence, but would on the contrary follow precedents and permit some equitable division of the blanket policy, for purposes of apportionment.

Gradual Reduction Rule

This rule is one of the most popular among adjusters, particularly in the Middle West where it has been in use for many years, and it has less to commend it than any other with the possible exception of the Albany rule. It is unsound in principle, is always inequitable in its results, and possesses but one virtue and that is, in the absence of co-insurance conditions, it will more frequently indemnify the insured, unless reapportionment is resorted to, than any other. But this virtue is largely neutralized by the injustice it always does to the blanket insurers, and by its inevitable discrimination against certain specific insurers when their policies cover on different items. And if the blanket policy contains the reduced rate average clause, as it usually does, the rule will in many instances have just the opposite effect from that intended, for the liability of the blanket policy

will be limited by the operation of the average clause, and the extra burden imposed upon it by the rule will be transferred to the insured.

The Gradual Reduction rule was adopted by the Supreme Court of Errors of Connecticut in the case of Schmaelzle vs. London and Lancashire Fire Insurance Company et al., 75 Conn. 397, 53 Atl. 863, 60 L. R. A. 536, 96 Am. St. Rep. 233, and more recently by the New Jersey Court of Errors and Appeals in Grollimund vs. Germania Insurance Company, 83 Atl. 1108. It was urged by the company having the specific policy in the recent Massachusetts case previously referred to, but was rejected by the court. Taber vs. Continental Insurance Company, 213 Mass. 487, 42 Insurance Law Journal 516 (supra).

It makes the blanket policy contribute first for its full amount on the item where the loss is greatest, then in remainder where next greatest, etc., thereby, in all instances magnifying the contributing power of said policy, and in many instances transforming it as a factor in contribution into a policy several times its original amount. Why the imposition should start with the greatest loss instead of the next greatest or smallest is not manifest; in fact the Connecticut Court in the Schmaelzle case frankly admitted that the starting point was purely arbitrary and intimated that the order of reduction might be determined by the highly intellectual and logical process of drawing lots. The ends of justice would probably have been served quite as well if the entire apportionment had been made in that way.

The Schmaelzle case has its ludicrous side. So absorbed were all the parties in the question of apportionment, that the fact that the blanket policy contained a co-insurance clause and that its maximum liability was absolutely fixed thereby was entirely overlooked. If this had been discovered, we would doubtless have had from the Court, instead of an argument in favor of the continuing gradual reduction of the blanket policy, a learned dissertation in favor of its conservation.

In the Schmaelzle case all the blanket policies were concurrent and all specific policies were concurrent. In the Grollimund case the specific insurances were in the same company, so that these are not ideal cases with which to illustrate the absurdity of the "gradual reduction" principle as a practical working proposition. Let us take for example: $10,000 specific insurance in Company "A" on building, $10,000 specific insurance in Company "B" on machinery, and $10,000 blanket insurance in Company "C" on building and machinery. Sound value of building $15,000 and loss $10,000. Sound value of machinery $15,000 and loss $9,999. No co-insurance conditions. Applying the Gradual Reduction rule commencing with the larger loss, Company "A"

pays 10,000/20,000 of $10,000 on building, or $5,000; Company "B" pays 10,000/15,000 of $9,999 on machinery, or $6,666, and Company "C" pays $8,333.

Conceding, of course, that the insured should be fully indemnified, and even conceding for the moment that the blanket policy should be penalized, what possible excuse can be given for making Company "B" with a policy covering for the same amount on an item with the same sound value and a smaller loss, pay $1,666 more than Company "A"? Why this extraordinary discrimination in favor of Company "A"?

This apportionment, which is self-evidently arbitrary, does a three-fold injustice: First, to Company "B" which is made to pay a sum unconscionably out of proportion to that paid by Company "A"; second, to Company "C" in that it is treated as if it were a policy for $15,000 instead of what it really is, one for $10,000; third, to the insured by reason of the fact that his best insurance (the blanket) is unwarrantably depleted, and solely in the interest of one of the specific insurers.

If the 100 percent reduced rate average clause be inserted in the blanket policy and the Gradual Reduction rule be applied, Company "A" pays $5,000, Company "B," $6,666, Company "C," $6,666.33 and the insured loses $1,666.67.

This apportionment, if possible, is even worse than the other, for the discrimination against Company "B" still remains and the burden which, in the absence of the average clause is saddled on to the blanket policy, is transferred to the insured who loses $1,666.67 in the face of the fact that he is fully insured.

It is argued by the advocates of the rule that if two or more independent fires occur, no matter how short the intervening time, the blanket policy will be gradually reduced by the first and by each succeeding fire, and in the payment of this series of losses its basis of contribution will in the aggregate exceed its face just as it does through the operation of the Gradual Reduction rule. That is quite true, but one loss is not two or more losses, and the amount of the blanket policy at the time of "any loss" is no more than its face. And there is no more warrant for magnifying it beyond that amount for purposes of contribution, than for loss paying purposes, and the latter is of course impossible.

The blanket insurer might easily be reconciled to having its policy gradually reduced and its contribution regulated by the course of events in the shape of a second or third fire which may never occur, but that is vastly different from having it gradually reduced and thereby greatly magnified as a contributing factor, by an arbitrary act in every single loss. The specific insurers might also cheerfully accept the

results accruing from the order of events, whereas they might justly resent the discrimination which inevitably attends the operation of the Gradual Reduction rule.

If three items are involved in a loss, six different combinations or orders of reduction are possible; if four items are involved twenty-four combinations are possible, and if five items, one hundred and twenty combinations, etc. Each one of these orders of reduction will produce a different result and neither is entitled to precedence over any other.

The rule always works an injustice to one interest, generally to two interests, sometimes to three interests; and any scheme of apportionment against which these indictments can be proven is indefensible.

The Finn-Griswold-Kinne Rule

The Finn rule which was first applied by its author in 1842 is substantially as follows: The contributive liability of the compound policy shall be based upon the loss (instead of the value as in the Reading rule) in the proportion that the loss upon the specific property shall bear to the loss upon all of the property covered by the general insurance.

This rule which failed to fully indemnify the insured in many instances, was modified by Griswold and still further modified by Col. Kinne in the rule which bears his name, which is the latest and probably the final development of the loss to loss principle. It possesses the merit of being consistent with itself in that it is made applicable to cases of simple as well as compound nonconcurrence. Its first application sometimes fails to give the insured full indemnity, which necessitates a reapportionment, and sometimes, though seldom, a second reapportionment. The idea of reapportionment is repugnant to many, and to the minds of some there is a serious fracture of the loss to loss principle the moment this becomes necessary. The rule, in the absence of coinsurance conditions, through its provisions for reapportionment, will always give the insured the fullest indemnity to which he is entitled, but the Reading rule or any other rule will do the same if unlimited reapportionment is resorted to.

In point of popularity among adjusters the Kinne rule will take rank with the Gradual Reduction rule. It has been in use on the Pacific Coast for over thirty years and in 1910 the Fire Underwriters' Association of the Pacific adopted it for general use among the companies in that territory, and by some members of the fraternity there and elsewhere it is regarded as the last word on the subject of nonconcurrent apportionments, as is evidenced by the following quotation from a recent address delivered by a prominent adjuster, "There is only one equitable rule, that is the Kinne rule, loss to loss, with reapportionment from excess to pay shortages."

The basis for this somewhat extravagant eulogy is not apparent. As a matter of fact the rule is simply one of several convenient makeshifts, none of which can lay claim to theoretical soundness any more than they can to general applicability. In addition to the criticism directed against its underlying principle by Mr. Rice, the Kinne rule will not only fail to fully indemnify the insured in many instances when co-insurance is present, but will come about as far from doing so as almost any other known rule, hence under present day underwriting conditions, it fails in the one point which of all others is chiefly instrumental in bringing it into being.

Some who favor the Kinne rule in preference to the Reading rule do so on the ground that the latter is too favorable to the blanket policy, evidently overlooking the fact that sometimes the reverse is true, and not infrequently the Kinne rule penalizes it less than the Reading rule.

The Modified Finn Rule

As the modified Reading rule is sometimes used when co-insurance conditions are present, so the modified Finn rule is occasionally used when those conditions are absent. It divides the blanket policy among the various classes of property so that when possible, and as nearly as possible, the ratio of available insurance to loss will be the same on each class as the total insurance is to the total loss on all classes.

The difference between the modified and the original Finn rules is similar to the difference between the modified and the original Reading rules; it takes into consideration both loss and insurance, and the relation of one to the other.

There is of course no authority in the policy for such arbitrary divisions and they could not stand if they resulted in reducing payment to insured.

The Rice Rule

According to Mr. Rice's rule, if the aggregate loss is less than the aggregate insurance, and the loss upon each subject covered by the specific insurance is less than the specific insurance plus the whole insurance available to pay the loss, there is contribution, as between the specific and collective policies, and every policy should enjoy a proportional abatement of liability. And the loss, if any, for which the general policy alone is liable, having been provided for, the insurance remaining under that policy should be apportioned for contributive purposes among the various subjects in the proportion that the maximum overinsurance on each bears to the aggregate overinsurance on all collectively.

By maximum overinsurance on each item is meant the excess of insurance over and above the loss on each item ascertained by adding the full face of the blanket policy to each of the specific policies. The Rice rule virtually makes an apportionment of the salvage in the ratio of the over-insurance. It is ingenious but, as has been pointed out, it is open to the same objection that Mr. Rice directed against the older well-known rules, that is, if the total loss be increased, the payment of some insurer may be diminished.

The Giesse Rule

This rule takes its name from the case in which it was first applied and is quoted verbatim:

> "First find the limit of liability of each class of insurance under the average or co-insurance clause, and find the total of those limits (which will usually be somewhat greater than the aggregate loss) by adding them together; then find what each class would pay if it got the full benefit of its contribution clause, i. e., contribution from the face or full amount of all other insurance covering the whole or any part of the property which itself covers, and find the total of these amounts (which of course will be less than the aggregate loss) by adding them together. We thus find the most each class can be made to pay, and also the least it can possibly get off for. Add the several differences between these pairs of limits, find what proportion of that total the aggregate excess of the upper limits over the aggregate loss constitutes, and deduct that proportion of each of the differences from the respective upper limits, to find what each class of insurance shall pay to make up the loss."

This rule was devised for use under reduced rate average or co-insurance conditions, and is of course not universally applicable. A great deal of ingenuity was displayed in its preparation, but as the basis upon which the lower limits are fixed is unsatisfactory, it follows that the result must be equally so in many instances.

The Morristown Rule

This rule is so named because of the fact that it was while adjusting a loss at Morristown, New Jersey, that the author received his inspiration.

The basis of this rule is the same as the lower limits, as fixed by the Giesse rule, the aggregate of which will be less than the loss. The deficiency is distributed among the various policies pro rata until each reaches its co-insurance or other limit of liability. Inasmuch as the basis is the same, it is subject to the same criticism as the Giesse rule. Furthermore, if in attempting to take care of the deficiency in the manner prescribed, the co-insurance limits of certain policies are reached, and a portion of the loss still remains unpaid, no arrangement is made for taking care of the deficit, and hence the rule frequently fails to fully indemnify the insured.

Conclusion

That the foregoing observations are mainly critical rather than constructive is due to the fact that virtually every conceivable phase of the question has been considered by the brightest minds that the business has produced, and although they have not led us out of the wilderness into the promised land, the methods suggested by them have been utilized in solving all the intricate questions in apportionment that have arisen up to the present time, and too much credit cannot be accorded to them for the study they have given, and for the efforts they have put forth in the attempt to perform the seemingly impossible task of finding a rule of universal application.

The question still confronts us; most of the rules possess some merit as means to an end, but the experts and the courts have never agreed upon a uniform and clearly defined method of apportionment—and probably never will—and as all of those in use are arbitrary, that rule should be applied to each specific case which will come nearest to doing substantial justice to the respective insurers, and at the same time give the insured the fullest indemnity to which he is entitled under the most generous interpretation, within reason, of the various contracts.

Judge Ostrander, in his well-known work on insurance, says: "Cases are sometimes presented where the complications defy human understanding. When this occurs—when reason is baffled and mathematics fail—arbitrary action becomes a necessity. The knot we cannot untie must be cut."

Writs of Attachment and Other Liens

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Writs of Attachment and Other Liens

Of all the matters connected with claims arising under policies of insurance, perhaps the most vexatious are liens and restraining orders which are known by various names such as warrants of attachment, writs of garnishment and trustee writs, the practical effect of which is to tie up the insurance fund and virtually make the garnishee a stakeholder or custodian of the defendant's property in his hands. And if there is any more highly favored party under the laws of this country (with the possible exception of a mortgagee under the mortgagee clause of a fire insurance policy) than an attaching creditor, he has not yet been discovered.

Insurance companies are not infrequently served with notices from attorneys stating that their clients have liens against any insurance money which may be due parties to whom they have sold goods and requesting, and sometimes demanding, that no payment be made without recognizing the interest of their clients. These so-called liens have no legal significance, but insurance companies are exceedingly conservative in the matter of loss payments and usually insist upon all liens, whether valid or not, being dismissed before making payment.

If a notice is received from a bailor who happens to have goods in the possession of a bailee, whose insurance policies cover "for account of whom it may concern," or contain the unrestricted "trust and commission clause," stating that he claims an interest in the insurance taken out by the bailee, it will be necessary for such notice to be respected, because, under policies so phrased the bailor might, under circumstances similar to those in the cases hereinafter cited, have a direct right of action against the bailee's insurers. Utica Canning Co. vs. Home Ins. Co., 132 App. Div. 420, 38 Ins. Law Journal 813; Johnson vs. Abresch, 123 Wis. 130, 101 N. W. 395. Czerweny vs. Ins. Co., 139 N. Y. Supp. 345.

Liens are sometimes filed by public adjusters and if the copy of the contract, which usually accompanies such notices, is so phrased as to constitute an assignment of a certain percentage of the adjusted loss, these liens cannot safely be ignored, but if the contract is not tantamount to an assignment, it is of no binding effect. Several years ago a prom-

ment company served notice upon public adjusters, great and small, that they must cease serving them with such liens, and that if persisted in they need not expect to collect any of their losses until the expiration of sixty days from filing proofs. The practical effect of this action was to put a stop to the persistent filing of liens by public adjusters. This rule, however, is not as inflexible as the laws of the Medes and Persians and has been waived in exceptional cases where unscrupulous claimants have deliberately attempted to evade liability to a public adjuster under a meritorious lien, when the latter has been instrumental in securing a fair adjustment.

There is no uniformity in the laws of the various states with respect to the matter of garnishment, either statutory or judicial, but the attitude of the State of New York on this question is very forcibly set forth in the case of Douglas vs. Phenix Ins. Co. of Brooklyn, 138 N. Y. 209, from which the following extracts in abbreviated form are taken:

"The right of a creditor of a corporation to prosecute an action to recover the debt in the courts of his own state cannot be defeated by the pendency of attachment proceedings against him in another state by a creditor there, when the only claim of jurisdiction by the foreign courts rests upon authority given by the statutes of its state to seize the debt by and through process proceedings against an agent of the corporation in that state.

In attachment proceedings the *res* must be within the jurisdiction of the court issuing the process, in order to confer jurisdiction.

A domestic corporation has at all times its exclusive residence and domicile in the jurisdiction of origin, and it cannot be garnished in another jurisdiction for debts owing by it to home creditors, so as to make the attachment effectual against such a creditor in the absence of jurisdiction acquired over his person.

The law of a state cannot make a debtor, who is actually a non-resident, a resident, by so declaring, at least so as to bind another jurisdiction by the declaration.

The legal proceedings or judgments of another state are recognized here only where jurisdiction has been acquired according to the course of the common law in the foreign forum; and this although the statutes of that state purport to give its courts jurisdiction, in disregard of the principles and rules of general jurisprudence, which this state is bound to recognize.

In an action upon a policy of insurance issued by defendant, a domestic corporation, it pleaded in abatement, in substance, that it was carrying on business, and maintained an agency in the state of Massachusetts; that pursuant to the laws of that state, it has appointed an attorney therein, upon whom process can be served; that prior to the commencement of this action, an action was brought by creditors of the plaintiff, residing in that state, against him, in which action defendant was made a party defendant as trustee of the plaintiff therein; * * * and by virtue of the attachment the sheriff levied on the debt due plaintiff from defendant upon said policy, that said action is still pending, and that by virtue of the laws of said state, its courts acquired full jurisdiction of the parties and control over the fund; that defendant had notice of all the proceedings in said action, 'and was duly served with process therein.' Held that a demurrer to this plea was properly sustained; that defendant was in no just or legal sense a resident of Massachusetts, had no

domicile there and was not the agent of plaintiff; and that, in contemplation of law the company and the debtor were, at the time of the issuing of the attachment, in this state, and not in Massachusetts."

The court further held:

"We deem it unnecessary to consider the position of the defendant. If it may be subjected to embarrassment or even to a double judgment, it will be in consequence of its own act in voluntarily subjecting itself to the laws of Massachusetts."

Whatever view may be entertained as to the soundness of ruling of the New York Court of Appeals, that a statutory assumption of jurisdiction by another state is subject to collateral attack whenever any deviation from the common law shall have occurred, especially if not in consonance with its own statutory laws, yet if the Supreme Judicial Court of Massachusetts were to compel payment to an attaching creditor in that state, in keeping with the statutory laws of that Commonwealth, and the courts of New York were to decide that the loss must be paid a second time to a claimant in that state, it would certainly seem directly in conflict with the full faith and credit clause of the Constitution of the United States as indicated in the cases hereinafter cited.

Article 4, Section I, of the Constitution of the United States, reads as follows:

"Full faith and credit shall be given in each State of the public acts, records, and judicial proceedings of every other State. And the Congress may by general laws prescribe the manner in which such acts, records and proceedings shall be proved, and the effect thereof."

Two decisions of absorbing interest have been rendered by our highest tribunal by reason of this provision of the Constitution, which bear directly on the subject of the jurisdiction of states in garnishment proceedings. The first of these, which is reported in 198 U. S. 205, that of Harris vs. Balk, is familiar to all law students. The caption of the decision, which was rendered by Mr. Justice Peckham in 1905 reads as follows:

"(1) The judgment of a state court, if that court has jurisdiction to render it, is entitled to the same faith and credit in the courts of another state that it is in the state where rendered as a valid domestic judgment.

(2) The temporary presence of the garnishee within the state gives a court of that state jurisdiction to render judgment against him in garnishment proceedings upon personal service within the state, if during such temporary presence in the state, the principal debtor could have sued him there to recover the debt, and the laws of the state permit the garnishment of a principal debtor.

(3) The consent of a garnishee to a judgment impounding his debt to the principal debtor does not make the payment under the judgment voluntary, where he was absolutely without defense, so as to prevent him from pleading such payment in bar to an action on the debt.

(4) The duty of the garnishee to give notice of the garnishment to the principal debtor is discharged by pleading the judgment therein in bar to an action on the debt while there remained nearly a year in which the principal debtor might litigate the question of his liability in the court which rendered the judgment."

Harris, a resident of North Carolina, was indebted to Balk, also a resident of North Carolina, in the sum of $180 for money borrowed under a verbal promise to pay, but there was no written evidence of the obligation. Jacob Epstein, of Baltimore, asserted that Balk was indebted to him in the sum of $300. Harris visited Baltimore for the purpose of purchasing merchandise and while there was served with a foreign or non-resident writ of attachment against Balk, attaching the debt due Balk from Harris. Before the return day of the attachment writ, Harris left Baltimore and returned to his home in North Carolina. He did not contest the garnishment, and August 11th, 1896 made affidavit that the amount had been attached by Epstein of Baltimore, and by his counsel in the Maryland proceedings, Harris consented therein to an order of condemnation against him as garnishee for $180, the amount of his debt to Balk. Afterward Harris paid the amount of judgment to one Warren, attorney for Epstein, residing in North Carolina.

On the 11th day of August, 1896 Balk commenced suit against Harris before a justice of the peace in North Carolina, to recover the $180. Harris pleaded in bar the recovery of the Maryland judgment and his payment thereof and contended that it was conclusive because the judgment was valid in Maryland and entitled to full faith and credit in the courts of North Carolina. Judgment was rendered against Harris, which judgment was affirmed by the Supreme Court of North Carolina. The ground of such judgment was that the Maryland court obtained no jurisdiction to attach or garnishee the debt due from Harris to Balk, because Harris was but temporarily in the state and the situs of the debt was in North Carolina. The United States Supreme Court in commenting on this case used the following language:

"It ought to be and it is the object of the courts to prevent the payment of any debt twice over. Thus—Harris, owing a debt to Balk paid it under a valid judgment against him to Epstein. He certainly ought not to be compelled to pay it a second time, but should have the right to plead his payment under the Maryland judgment. It is objected, however, that payment by Harris to Epstein was not a legal compulsion. Harris in truth owed the debt to Balk which was attached by Epstein. He had, therefore, as we have seen, no defense to set up against the attachment of the debt. Jurisdiction over him personally had been obtained by the Maryland court. As he was absolutely without defense there was no reason why he should not consent to a judgment impounding the debt, which judgment the plaintiff was legally entitled to and which he could not prevent. There was no merely voluntary payment within the meaning of that phrase as applicable here.

But most rights may be lost by negligence and if the garnishee were guilty of negligence in the attachment proceedings, to the damage of Balk, he ought not to be permitted to set up the judgment as a defense. Thus it is recognized as the duty of the garnishee to give notice to his own creditor, if he would protect himself, so that the creditor may have an opportunity to defend himself against the claim of the person suing out the attachment. While the want of notification by the garnishee to his own creditor may have no effect upon the validity of the judgment against the garnishee (the proper publication being made by the plaintiff) we think it has and ought to have an effect upon the right of the garnishee to avail himself of the prior judgment and his payment thereunder. The notification by the garnishee is for the purpose of making sure that his creditor shall have an opportunity to defend the claim made against him in the attachment suit. Fair dealing requires this at the hands of the garnishee. Balk had notice of the proceedings in Maryland, but took no action.

Generally though, the failure on the part of the garnishee to give proper notice to his creditor of the levying of the attachment would be such a neglect of duty on the part of the garnishee, which he owed to his creditor, as would prevent his availing himself of the judgment in the attachment suit, as a bar to his creditor against him, which might therefore, result in his being called upon to pay the debt twice."

This litigation over a $180 debt came before the Supreme Court of North Carolina on several occasions. It lasted from 1896 to 1905 and after nine years was reversed and remanded by the Supreme Court of the United States.

This decision has been quite severely criticized by a prominent professor of law who declares it to be unjust and unsound. He thinks that Epstein should not have been permitted to attach the debt due from Harris to Balk until he had first secured a judgment against Balk, and this certainly seems reasonable at least to a layman. Let us analyze the situation. A, a citizen of California, is indebted to B, also a citizen of California, in the sum of $500. A happens to be in the state of Maine and is served with a writ of attachment by C, who claims that B is indebted to him in the sum of $500. A notifies B that such writ has been served upon him. C has secured no judgment against B and C's claim is unjust, but B must go to the trouble of defending this action in Maine, 3000 miles distant, and in order to properly protect his interest he might be under the necessity of traveling all this distance and appearing at the trial, and it is self evident that it might be better for him to lose the $500 than to incur the expense which would be incurred in an attempt to save it.

There is another United States Supreme Court decision somewhat analogous to that of Harris vs. Balk (supra) recorded in 240 U. S. 620, which is entitled "Baltimore and Ohio Railroad Company against Hostetter." Hostetter, the defendant, a resident of West Virginia, sued in a Justice's Court in that state for wages due him by the railroad company. The defense was that the wages had been paid by the railroad company as the result of a garnishment proceeding taken against it in Virginia where it was suable to

enforce a judgment rendered in Virginia against Hostetter when he resided in that state and after a domiciliary service on him.

The West Virginia court held that the garnishment proceeding was not entitled to be enforced against Hostetter under the full faith and credit clause of the Constitution of the United States because he was not served with process in such proceedings, he then residing in West Virginia, although extra judicial notice was given him by the railroad company.

The plaintiff in July, 1911 resided in Clifton Forge, Virginia, and was indebted to one Wagner in the sum of $35, for which debt Wagner obtained a judgment against him in a Justice's Court in Virginia based on a summons served "on said plaintiff - - - - - - by delivering a copy thereof to the wife of the plaintiff at his usual place of abode." Said record further shows that on the 17th day of September, 1912, a garnishee summons was directed against the Baltimore & Ohio Railroad Company; that on the third day of October, 1912, judgment was rendered against Hostetter and the Baltimore & Ohio Railroad in favor of Wagner for $38.40 and interest. In these garnishment proceedings no notice or process of any kind was served on Hostetter who then resided in West Virginia. But on February 14th, 1913, after an appeal had been taken by the Railroad Company in the garnishment proceedings, it notified Hostetter in writing of the pendency of the garnishment proceedings on appeal. It was not contended that any formal notice was given to Hostetter of the garnishment proceedings for the reason that the statute of Virginia does not require notice to be given to a non-resident of that state of pending garnishment proceedings.

The United States Supreme Court overruled the courts of West Virginia and held that the Baltimore & Ohio Railroad Company could not be compelled to pay the second time the sum it had discharged under the Virginia judgment, citing the following cases:

C. R. I. & P. R. R. Co. vs. Sturm, 174 U. S. 710.
Harris vs. Balk, 198 U. S. 215.
L. & N. R. R. Co. vs. Deer, 200 U. S. 176.

It will be observed that in this case a judgment had been rendered against Hostetter in favor of Wagner, thereby distinguishing it from the case of Harris vs. Balk (supra) and this would seem to meet the point raised by the law professor above referred to against the former decision, although even if no judgment had been rendered, the Supreme Court would no doubt have stood by its decision in the Harris vs. Balk case. And thus a case great in principle, but involving only $35.00 in amount, engrossed the attention of the greatest tribunal in the world.

There is a case pending at the present time where the loss occurred in Oklahoma and the claim was garnished by a large packing company in Chicago, whose claim amounted

to more than the total loss. Later, garnishment proceedings were brought by a resident creditor in Oklahoma. The representative of the company in Chicago inadvisedly admitted that it was justly indebted to the insured for the amount of the loss as adjusted, whereupon judgment was rendered in favor of the attaching creditor in that state. This fact was set up in the Oklahoma proceedings, but the attaching creditor in that state is persistent in his efforts to secure the insurance fund. The matter has been in litigation for a year or more and is still pending.

The practice of attorneys with respect to the matter of making answer in garnishment proceedings seems to differ, but it is submitted that the custom which prevails in the East, of making non-committal answers irrespective of whether or not the loss has been adjusted, is the better practice; in fact, it can truthfully be said that the Company has no money belonging to the insured until the claim has matured, that is, sixty days after the receipt of satisfactory proofs of loss, and the New York Court of Appeals has so held (Douglas vs. Phenix Insurance Company, supra).

There would seem to be no reason why the garnishee cannot with perfect propriety make answer in garnishment proceedings, by saying that it has not yet determined whether or not it has any liability even though the loss may have been adjusted and the claim may have matured, for until payment has actually been made there is a possibility of some development which will afford a valid defense under the policy.

If this position were taken, or liability denied in the garnishment proceedings, it would be incumbent upon the attaching creditor to affirmatively prove that the company had a liability to the insured, and in many instances the expense of proving this would be in excess of the creditor's claim. If, on the other hand, as has not infrequently been done in some sections, the Company passively admits liability, judgment can be taken and the pathway to the Company's exchequer made exceedingly easy to the attaching creditor.

In some jurisdictions, under certain circumstances, the court makes the garnishee a small allowance for expenses in filing answer to the garnishment proceedings, especially when the attachment does not lie, but as a rule insurance companies, under the laws as they exist, are under the necessity of incurring all the expense incidental to making answer, and if there are a number of garnishments against the claim, this expense amounts to no inconsiderable sum, and this is particularly true when garnishments are filed against the company in two or more jurisdictions.

Writs of attachment are positively a source of trouble and expense to insurance companies at all times; they are comparatively so when the loss is in one state and the

garnishment in another, and they are superlatively so when two or more garnishments are pending in different states. It is said that companies have been compelled to pay losses twice under these latter conditions, but it would seem that if properly handled, this could have been avoided by invoking the full faith and credit clause of the Federal Constitution, which was certainly intended to prevent such a result.

In New York it is made the duty of a person or corporation upon whom or which a notice is served, to furnish a certificate to the sheriff showing the nature, amount, and description of the interest of the defendent in any property or debt in the hands of such person or corporation. Any one under this duty, who refuses to perform it may be ordered before a court or judge for examination.

The certificate furnished is evidence against the person or corporation making it, but it is open to explanation in case of mistake. It is customary, therefore, to be quite non-committal in making answer to these proceedings, simply saying that a policy has been issued to the defendant covering certain property; that a loss has been reported, but that the company has not determined its liability, if any, in the premises. When this is done the insured should be notified of the fact that the claim has been attached and then await developments. This mode of procedure usually results in the settlement of the claim and a dismissal of the proceedings.

When making answer to a writ of attachment, if any writs have been previously served, or if the claim has been assigned, or if the loss under the policy is made payable to a third party, these facts should be fully set forth. An assignment may be subject to attack on the ground of fraud, and it will not be safe to pay the assignee of a claim unless the attachment proceedings are dismissed. The claim of a named payee under the policy, however, takes precedence over that of an attaching creditor, or of a trustee or assignee in bankruptcy, and he will have no difficulty in enforcing payment. Ordinarily when the attention of an attaching creditor is called to the fact that the loss is payable to a third party, whose interest exceeds the amount of the loss, he will dismiss the proceedings. When, however, there are numerous claimants to the fund it frequently becomes advisable to pay the money into court, provided all claims are within the same jurisdiction.

A circumstance frequently affecting the validity of legal liens such as garnishments, is the bankruptcy of the insured. Section 67 of the Federal Bankruptcy Act provides that such liens, except under circumstances which are not material in this discussion, will be dissolved by the adjudication in bankruptcy provided (a) that the lien was obtained within four months prior to the filing of the petition in bankruptcy and (b) that the bankrupt was in fact insolvent at the time when

the lien was obtained. If the lien was procured more than four months prior to the filing of the petition in bankruptcy or if the bankrupt was still solvent at the time when it was obtained, the lien continues in effect.

In normal times every large fire insurance company is liable to be served with several writs of attachment each month, but during the period of deflation which has been in process for the past year there has been a veritable avalanche of garnishments and liens filed against insurance companies, and it is not at all unusual for a company to receive a single telegram containing notice of three or four garnishments, and in a case recently settled in Kentucky twelve writs of attachment had been filed against the claim.

It will be seen from the foregoing analysis that the laws are highly favorable to the attaching creditor; that they are correspondingly unfavorable to the debtor and still more unfavorable to the garnishee, who is invariably subjected to more or less trouble, and not infrequently to considerable expense, wholly in the interest of the attaching creditor. There should be some provision made for reimbursing the garnishee, at least for actual expenses incurred in connection with the garnishment proceedings.

Years ago it was the practice of virtually all insurance companies to issue, or have their field representatives issue, sight drafts in payment of losses reading "Pay to the order of..............................". But largely on account of the difficulties connected with garnishments and the element of doubt as to what constituted payment under this form of draft many companies now issue only "Acceptance Drafts" reading "Upon acceptance pay to the order of.." If, therefore, the company receives notice before the draft is accepted that the claim has been garnished, acceptance, or payment can very properly be refused.

When a garnishee summons or a similar document is served upon a local agent he should promptly telegraph the company, giving sufficient details to enable it to identify the loss, and should forward the summons by first mail. He should also notify the general or state agent having jurisdiction in order that the matter may receive prompt attention.